The New York Certified Public Accountant

EMANUEL SAXE, *Managing Editor*
EDITORIAL BOARD
STEPHEN CHAN, *Chairman*

GILBERT BYRNE
JOEL HUNTER, JR.
GEORGE M. LUBIN
JOHN G. McCULLOCH
CHARLES MEYER
BENJAMIN NEUWIRTH

VOL. XXI *April · 1951* No. 4

Society and Editorial Offices: 677 Fifth Avenue, New York 22, N. Y.
Copyright, 1951, BY THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

BOOK REVIEWS

Modern Corporate Reports

By Lillian Doris. PRENTICE-HALL, INC., New York, N. Y., 1948. Pages: ix + 309; $10.00.

In clear, fresh language which is a model of business writing, this book deals with the production of corporate reports to stockholders, employees, and the public. Its 21 chapters and hundreds of illustrations show how the best corporate reports are prepared, what they cover, and how they cover it.

While the book is directed primarily to those who prepare the narrative section of corporate reports, it contains much information of value and interest to the public accountant. There is a chapter on financial statements which summarizes current trends in accounting terminology and form, and explains the difficulties which the untrained reader of financial statements has in reading them.

Other chapters deal with the presentation of information about production; volume of business; earnings and dividends; employment, wages, and employee relations; ownership; and research, advertising, and selling. A chapter is devoted to the problem of bringing stockholders and management together, how to enlist stockholder support, how to get public-relations benefit from annual and regional meetings. In recognition of the role the annual report plays in influencing the views of leaders of public opinion, a chapter is devoted to methods of winning the goodwill of the public as well as that of the stockholder. A thoughtful discussion of the special problems of reporting to employees gives the arguments in favor of a single report for all purposes and those in support of a separate report directed to employees alone. The value of sincerity and frankness is emphasized.

Valuable suggestions are offered about such matters as making the best use of dividend enclosures as a means of conveying information and building goodwill. The book is most generously illustrated with charts, graphs, and statistical data, and with excerpts from the text of some of the best reports that have been issued by forward-looking companies. Suggestions are made about such practical matters as paper, use of color, printing, type faces, envelopes, and ideas for covers. A discussion is included of the advantages and cost of having the report prepared by an outside agency or annual report counselor. The results of several surveys made to determine what the annual report should include are given in revealing detail.

There is also a chapter written by Dr. Rudolph Flesch on making the narrative readable, which may be read with profit by everyone who writes, even if his product is restricted to financial statements accompanied by a short-form report.

The book has a most attractive format, readable type, and a comprehensive index. Both private and public acountants will enjoy its contents.

JENNIE M. PALEN

New York, N. Y.

Accountant's Rapid Tax Finder

By Paul M. Johnson. PRENTICE-HALL, INC., New York, N. Y., 1951. Pages: vi + 117; $5.95.

This is a practical calculating short cut that eliminates much of the mechanical computational work encountered by the accountant in the preparation of tax returns. Simple addition of easily found tabular data produces the required tax in each case, and eliminates much time and effort on his part. The tables may be used either for the original computation or for the recheck thereof. They will be found to be particularly helpful in connection with the preparation of fiscal year returns. The reviewer has himself used the Tax Finder with excellent results.

Tax Savings in Real Estate Transactions

Published by the BUREAU OF ANALYSIS, Davenport, Iowa, 1951. Pages: x + 98; $5.00.

This little book offers up-to-date solutions to many of the tax problems involved in handling real estate. Each tax saving method presented is supported with appropriate authorities. Publication was sponsored by the National Institute of Real Estate Brokers and approved by its editorial board.

It is the first and only book on this subject to use a functional, editorial approach to federal income taxes. Tax saving principles and methods are explained clearly, and have been classified according to the type of transaction (including sales, purchases, exchanges, leases, defaults, etc.) to facilitate reference.

Written expressly for those who wish to know quickly the best method of legitimate tax saving available, the book should be of considerable value to all who are concerned with the day-to-day handling of real estate transactions.

(Continued on page 237)

YOUR CLIENTS MAY APPRECIATE GETTING THIS INFORMATION

CORPORATION OFFICIALS frequently face the problem of investing surplus funds, reserve funds, trustee funds, funds for depreciation, reserves for taxes, etc. They look for: 1. security of principal—2. availability—3. reasonable return.

YOU'LL FIND ALL 3 in a Corporate Fund Account at NINTH FEDERAL. Each Company is insured up to $10,000 by Federal Savings And Loan Insurance Corporation. Savings dividend rate has never been less than 2% per year, credited semi-annually. To conserve savings dividends upon funds withdrawn before end of dividend period, passbook loans are available.

FOR FURTHER INFORMATION, ask for Folder CP-1. Phone or write Edgar R. Tostevin, Treasurer.

NINTH FEDERAL SAVINGS & LOAN ASS'N

1457 BROADWAY • TIMES SQUARE • 587 7th AVENUE

WIsconsin 7-9120 • Open Monday-Thursday to 3; Friday to 6

Book Reviews

(Continued from page 236)

Handbook of Tax Accounting Methods

Edited by J. K. Lasser. D. Van Nostrand Company, Inc., New York, N. Y., 1951. Pages: xii + 897; $12.00.

This is the third volume in the Lasser Handbook series, and is designed to guide those who seek information with respect to the unusual, i.e., the variations, in the taxation of ninety-seven different industrial, business, agricultural and professional fields. Outstanding authorities have contributed sections in the fields of their respective specialties, which will help the reader to solve practical tax problems in the particular industries covered.

Section I (130 pages) was written by Mr. Lasser and contains a survey of basic tax principles applicable generally to all businesses. Section II (736 pages) presents the specialized tax information for each of the ninety-seven selected industries. Section III (31 pages) is a bibliography of published tax materials in all of the fields covered in Section II.

This reviewer "sampled" some of the articles in Section II, in areas with which he has had contact, and found them to be both comprehensive and clear.

Emanuel Saxe

Handbook of Personnel Forms and Records—Research Report Number 16

By Eileen Ahern. American Management Association, New York, N. Y., 1949. Pages: 227; $3.50.

This Handbook should be a part of the library of every accounting firm. It is the result of research that has been based in part on an analysis of forms from over 1000 representative companies that have been exhibited in AMA's Personnel Workshop held in conjunction with the Association's Personnel Conferences. More than 150 pages of the report are devoted to reproductions of carefully selected forms currently in use. Included are several checklists of items found on hundreds of examples of similar forms. Wide variations in layout, typography, arrangement of items, size, is evident from the illustrations, and a number of forms of unusual interest are described.

The report covers all types of forms and records included in the following broad categories: application forms, interview records, references, medical forms, induction of new employees, payroll notifications, job evaluation, attendance and absence records, manpower inventory, merit rating, training, group

(Continued on page 238)

When writing to advertiser kindly mention The New York Certified Public Accountant.

BOOK REVIEWS

(Continued from page 237)

insurance, employee discipline, grievance records, and suggestion systems. Each of the categories is introduced with editorial comment and material that gives critical analysis of the particular personnel activity discussed and the underlying principles governing its administration. The Handbook thus provides a broad-gauge frame of reference within which executives may examine the functions of the forms illustrated, and pre-test new forms that they may draft.

In the preface Lawrence A. Appley, President of the Association, stresses the critical use of the Handbook. He says, "there is some danger, in the case of a publication of this kind, that a few persons may select a form from each of the groups presented and expect them to mesh together effectively. Actually, some attractive forms may be inefficient . . . other forms, less pleasing in appearance may be well designed for their purpose. . . . All forms should, of course, be periodically reviewed to ascertain whether they are fulfilling the functions for which they were originally intended."

The wealth of ideas and information contained in this Handbook becomes ever more apparent as one glances through it time and again. Much of the purpose of design of the numerous types of forms becomes meaningful only as they are applied to the practical test of checking one's own forms already in use, or in the attempt to design new ones. It is fascinating to check one's own interview technique against the Interview Guide, or to evaluate one's own method of rendering judgment on personnel by following the Judgment Blank. The checking of references by telephone is facilitated by a simple Telephone Check-Up Guide. One of the thought-provoking suggestions is found in Job Description, something that can no longer be overlooked. For how can one possibly find the right person for the right job, if the tools at one's disposal, while permitting the selection of the right person, do not measure one's need for the particular job to be filled? The Merit Rating section will not let one forget how important it is, since so many of one's judgments are based on a subjective approach, to create safeguards and accuracy of rating so that the most objective point of view will prevail. Quite obviously this does not apply just to the rating section. Objectivity seems to have been the guiding principle throughout the preparation of this stimulating book.

WERNER E. REGLI

New York, N. Y.

BUSINESS PERSONNEL AND OPPORTUNITIES

Help Wanted:	**20¢ a word, minimum $5.00.**
Situations Wanted:	**10¢ a word, minimum $2.00.**
Business Opportunities:	**15¢ a word, minimum $3.00.**

Box number, if used, counts as three words.

Closing Date—15th of month *preceding* date of publication.

BUSINESS OPPORTUNITIES

Mail and Telephone Service: Desk provided for interviewing. $5.00 per month. Directory Listing. Modern Business Service, 505 Fifth Avenue, New York (42nd Street).

C.P.A., 38, Society member, former Revenue Agent, moderate practice, desires to expand by purchasing individual accounts or practice in Metropolitan area or Long Island. Liberal terms. Box 363, New York C.P.A.

Accountants for permanent staff positions. Good education and personality, and few years of industrial and public accounting experience preferred. Will give consideration to capable accountants without public experience but with desire to enter the field permanently. Upstate location. Box 365, New York C.P.A.

N. Y., N. J., Penna. and Conn.

C.P.A. desires to purchase accounting practice or offers good income to retiring accountant. Liberal terms offered. Box 366, New York C.P.A.

Calculating Service

Inventories computed, sales analysis, etc. Special service to C.P.A.'s. Verna Crawford, 565 Fifth Avenue, ELdorado 5-0280.

C.P.A., Society member, modest practice, excellent qualifications, desires working arrangement or partnership with overburdened practitioner. Box 367, New York C.P.A.

C.P.A., 34, ambitious, personable, moderate practice, enjoys excellent reputation in textile credit field and banks; seeking associate with similar qualifications to establish an accounting firm. Box 368, New York C.P.A.

SITUATIONS WANTED

Statistical Typing

Financial reports, tax returns, expertly typed—reasonable—confidential—ten years certified experience. Thorough knowledge all details. JUdson 6-3879.

Accountant, Pace graduate, B.B.A., 2½ years diversified C.P.A. experience including taxes, audits, write-ups. Married veteran, age 31. Box 364, New York C.P.A.

Statistical Typist

Available after March 15 several evenings weekly and Saturdays; schedules, reports—Mr. R. Gang, 213 Nagle Ave., NYC 34.

One day week or month. Bookkeeping, auditing, accounting, taxes, small accounts welcome. Formerly with U. S. Internal Revenue Dept. James F. Casey, 32 Broadway, N. Y. WH 4-6680.

FROM **JUNIOR** TO **SENIOR**

*A **Proven** ACCOUNTANTS PERSONNEL SERVICE*

"QUALIFIED PERSONNEL"

for the PUBLIC ACCOUNTANT and his CLIENTS

CAGEN *Personnel Agency*

509 5TH AVENUE, NEW YORK 17, N. Y. • MU 7-3250

DEPENDABLE
Employment Agency
220 W. 42nd St. N. Y. 18

BRyant 9-7666

We Specialize in servicing Accountants and their clients with dependable male and female personnel

- COMPTROLLERS
- OFFICE MANAGERS
- ACCOUNTANTS
  - C.P.A.'s
  - Seniors, Semi-Srs.
  - Juniors
- SALES
- BOOKKEEPERS
  - Full Charge
  - Assistants
- SECRETARIES
- STENOGRAPHERS
- TYPISTS
- CLERKS

Established 1939

Wm. Schnuer, BBA, MBA
Licensee

Shirley Schnuer
Licensee

BU **Bookkeepers** UNLIMITED

The Employment Agency for Bookkeepers

OURS IS A SPECIALIST ORGANIZATION, PROVIDING RESPONSIBLE AND THOROUGHLY EXPERIENCED BOOKKEEPING PERSONNEL — *Exclusively.*

299 MADISON AVENUE • NEW YORK 17 • MUrray Hill 7-5821

APPRAISALS

NATIONAL ORGANIZATION OF APPRAISAL ENGINEERS

STANDARD APPRAISAL COMPANY

BOSTON
PHILADELPHIA
PITTSBURGH

6 CHURCH STREET
NEW YORK, N. Y.

ATLANTA
CHICAGO
ST. LOUIS

specializing in the employment requirements of the public accountant and his clients

ROBERT HALF

personnel agencies

140 w. 42 street
new york city
longacre 4-3834

25-15 bridge plaza n.
long island city
stillwell 6-5707

directed by a certified public accountant

MANUFACTURERS OF

PRESSBOARD FOLDERS

SPEAKING OF REPORT COVERS

let's take a look at the cover you are now using. Has the stock the snap and strength of high grade paper . . . Is the printing or engraving well planned . . . In short, as your representative in your client's office, will your present cover make the right impression? Write for samples.

N. L. & E.W. KRUYSMAN, Incorporated
11a Frankfort Street New York 7, N. Y.

EXPANDING ENVELOPES

EXPANDING FILE POCKETS

IF SOMEONE IN YOUR FAMILY HAD CANCER, you would do anything . . . everything that would help. And today there is so much that you can do to help.

Doctors can now cure half of those who develop cancer if the disease is diagnosed in its early stages. Yet in 1950 some 210,000 families lost a father, a mother or a child to cancer.

We need more research, more life-saving education, more training for scientists and physicians, more equipment, more services for those already stricken with the disease. We all must help. Any contribution is welcome, but the fight against this major threat deserves major support: dollars—tens—twenties—hundreds of dollars. Will *you* help?

AMERICAN CANCER SOCIETY

THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT

EMANUEL SAXE, *Managing Editor*

The matters contained in this publication, unless otherwise stated, are the statements and opinions of the authors of the articles, and are not promulgations by the Society.

VOL. XXI *April • 1951* No. 4

President's Message

THERE cannot be much doubt about what the subject of the president's message for this month will be. The regulatory accounting bill, which the Society sponsored, was defeated on March 15th in the Senate of the State of New York by a vote of 31 to 24. While reported out of committee in the Assembly, it was not brought to a vote there.

The Committee on Legislation worked long and hard to persuade the legislature that this bill was genuinely in the public interest and that it provided for the proper regulation of the practice of professional accountancy and for the practice of the profession in a way which was fair to all and which safeguarded the rights of all practitioners, certified or uncertified.

The bill had the approval and active support of several groups which the profession can count as old friends. Among these was the New York State Bar Association which endorsed the objectives and principles of the bill. The New York Credit and Financial Management Association, the New York State Bankers Association, and the Robert Morris Associates all supported and helped us. Many individual friends of the profession worked for the bill.

The opposition to the bill came to some extent from quarters where it was expected, but some of it came from wholly unlooked-for sources. Perhaps the strangest type of opposition came from certain commercial schools which professed to believe, and stated with much emphasis to members of the legislature, that the Certified Public Accountants were endeavoring to prevent their students from earning a livelihood.

New York has always been a leading state in education and in the regulation of the professions in the public interest. It has been a leader in accounting legislation as well as in that covering other professions. Perhaps the state was not ready to go as far as we would like towards the goal of an accounting profession where all truly professional accounting work would be done by accountants whose qualifications had been passed on by the state. The difference between professional accounting work and accounting work of other types, while we thought it was made clear in the law, was obviously not well understood. Running through much of the opposition to the bill was a note of fear that the Certified Public Accountants were endeavoring to set up some sort of a monopoly and were trying to make it more difficult than ever to become a Certified Public Accountant. This obviously was not so.

We have learned a great deal from the effort to secure the passage of this legislation. Among other things, it has been made quite clear that there is still much educational work to be done among the other professions, with members of the legislature and with businessmen if we are to have a thorough understanding of what professional ac-

(Continued on page 263)

Airport Accounting for The Port of New York Authority

By Karl G. Clement

THE development of a comprehensive system of airport accounting, particularly of airport cost accounting, has been of comparitively recent origin. In March, 1947, when The Port of New York Authority assumed the responsibility for operating La Guardia Airport (the first member of its system of four regional airports) under the terms of a lease agreement with the City of New York, it had several objectives in mind and one of its first steps was to research the field of available airport accounting data.

The majority of large airports in this country have been municipal in origin and in operation. This has meant and continues to mean, in most cases, that an inclusive income and expense statement is seldom developed. It is true there is usually a meticulous accounting for the directly identifiable items of operating and maintenance expense. But rarely is there a complete accounting for all related expenses including policing, personnel, administration, accounting, legal, and like services usually furnished by different city departments, nor is there included an item for debt service or depreciation on the investment in land, runways, buildings and other facilities. Yet to portray the true status of an airport's operations on an economic basis it is necessary to make such determinations.

Karl G. Clement, Deputy Comptroller of The Port of New York Authority, is a member of the Controllers Institute of America, serves on their Cost Accounting and Analysis Committee, and is a member of the American Management Association, Finance Division, Planning Council. He was formerly Comptroller of the Vick Chemical Company, and is a graduate of the University of Minnesota School of Business Administration.

This paper was presented by him at a technical meeting of the Society held on December 5, 1950, under the auspices of the Committee on Air Transport and Airport Accounting.

Since apparently there did not exist a clear-cut presentation or understanding of the over-all problem as envisaged by the Authority, it was found necessary to commence the development of such a system.

It is the Authority's conclusion that in order to place airports on at least a break-even basis, accurate information is required by management as to the amount of investment in and the operating costs of the various revenue producing facilities on each airport—including a proper share of the costs of the necessary non-revenue producing facilities and activities which must be provided. That is, to arrive at the true cost of operating an airport all expenses must be distributed, under sound accounting principles, to the airport and to the areas capable of producing revenue to which they apply. Such data then provide a guide as to an intelligent basis for developing and expanding the airport and for use in measuring the effectiveness of and in setting rates, rents, tariffs and in negotiating leases, permits, etc.

Simply stated then, this system is based upon the concept that there must be a complete accounting for all expenses related to the operation of the airport—both direct and indirect—and a complete allocation of such airport

costs to each revenue producing cost center at the airport. Naturally Port Authority conclusions and procedure are not necessarily suitable for use in all situations. Circumstances, size, location, and local conditions may well govern otherwise. For the Authority its system does furnish actual and realistic costs covering all of its expenditures, and that is its objective.

The Port of New York Authority

The Port of New York (and New Jersey) Authority was created in 1921 to handle integrated port planning and development in the Port District, and to protect its trade and commerce by eliminating congestion, duplication and waste. The Port District includes, roughly, the metropolitan New York and New Jersey area falling within a radius of 25 miles from the Statue of Liberty. The problems of trade and commerce within this area are regional in character and are not confined by state, county or municipal boundry lines.

To accomplish these ends the two State legislatures, by a Port Compact, created the Port Authority as a body, both corporate and politic, with full power and authority to purchase, construct, lease and operate any terminal or transportation facilities within the Port District. The Authority currently operates sixteen facilities — including bridges, tunnels, airports, marine, truck and bus terminals, an inland railroad freight and a grain terminal. Its mission is primarily to raise the necessary funds, to provide those facilities which cannot be provided by private capital, and to administer them.

The Port of New York Authority is at present engaged in the construction, rehabilitation, operation, maintenance and development of four major airports; La Guardia and New York International in New York State, and Newark and Teterboro in New Jersey. This undertaking is believed to be the largest operation of an airport system in the world. The New York region, all of which is under Port Authority operation, currently handles 6% of total U.S.A. air carrier movements, and over 45% of the total of Chicago, Washington and New York combined. With respect to passengers, this region accounts for over 13% of the U.S.A. total. During the twelve months ended September 30, 1950, there were 233,000 plane movements at these airports; over 4,025,000 revenue passengers were handled by U.S. Scheduled Domestic Airlines and over 485,000 by the U.S. and Foreign Scheduled Overseas Airlines. In addition, 31,347,000 pounds of domestic and 8,711,000 pounds of foreign mail were handled; and over 189,000,000 pounds of freight and express.

The four Authority airports cover over 7,300 acres, and they are in the process of being expanded to approximately 8,500 acres. Each of these airports is different in size, physical layout, age, stage of development, volume of operation, maintenance requirements, etc. From these considerations it can be appreciated that the Port Authority was, and is being faced with many new and varied problems in creating and in maintaining a comprehensive system of airport accounting.

Considerable ingenuity was required in meeting, considering and disposing of cost accounting problems not hitherto dealt with by management. The result, after three years of intensive study, has been a well developed airport accounting system plus several years of experience with it.

As it is necessary to an understanding of the problem, the nature of The Port of New York Authority and its general accounting requirements are of interest. The Authority is a self-supporting, non-political agency of the two states. It has no access to taxes or to state and government guaranties. Its approach to problems must necessarily be that of self-financing business. It has developed a stable, versatile career staff, organized and designed to apply aggressive modern techniques of business to the problem of providing, operating and

developing terminals and to the task of port-wide promotion and protection.

It is important to note the fact that the Authority is self supporting—since it is for this reason its approach to any problem must be on a businesslike basis. When funds are required to finance capital expenditures its Treasurer must go to the banks, insurance companies, underwriters and public—and convince them of the long range soundness of its projects on a revenue basis—without guarantee by any municipal, state or federal agency.

Airport Accounting Principles

Comparison with Industrial Accounting Principles

Because of its rather unique status, there are points of difference between standard industrial corporation accounting and Port Authority accounting. While the disposition of the Authority's revenues each year is controlled by requirements and specifications of its statutes, and of its various covenants with bondholders—excepting for these requirements, the Authority is free to set up and conduct its financial administration in accordance with generally accepted accounting principles.

Depreciation accounting is required in the case of airport cost accounting since there are many classes of property with various estimated lives. Many of the buildings, types of pavement, and other improvements have short periods of useful life.* At the airports, where each entire facility has to be eventually returned to the Cities of New York and Newark, debt free, all Port Authority investment and interest cost must be recovered by that time. Investment in land, for example, must be treated as an item to be amortized over the period of the 50-year leases with the cities, just as any normal depreciable item of property. At these facilities, the basis of write-off is length of life or remaining period of lease, whichever is the shorter.

Responsibility Accounting Concept

The basic concept of the Port Authority accounting system is the principle of *responsibility accounting.* Responsibility accounting means the collection, recording and reporting of expenditures by the activities or functions of certain organization units which have been assigned the responsibility for carrying out certain functions related to the provision, financing, administration, supervision, operation and maintenance of the Port's facilities. Organization units are management groups of persons to whom responsibility is delegated for carrying out activities under its control. The accounting records reflect such responsibility. Every item of expenditure must be approved by and accepted by an organization unit, and the Authority's system of budgetary control ties in directly with its accounting system and this principle of responsibility. Object classifications are not set forth separately. That is, separate accounts are not maintained for payroll, materials, rent, telephone, etc. Rather, these items are included in the appropriate activity account of the organization unit concerned, and are available, naturally, upon analysis. Each unit is given a job to do, is authorized a certain amount of money with which to do it, and is controlled by the performance of that job within the budgetary allowance regardless of how the individual dollars are spent.

Accounting for Expenditures

Under the Authority's accounting system all expenditures whether operational or capital, and whether incurred in the central offices or at a facility, are ultimately charged to the individual Port Authority facilities as expenses, or to its capital projects as Investment in Facilities.

Each item of revenue or expenditure requires approval (acceptance), coding and classification prior to its entry in

* See Appendix for typical depreciation rates.

the accounting records. Each activity account coding furnishes various kinds of information: the fund concerned; the operating facility, capital project, or administrative program for which the activity is performed; the organization unit responsible; the activity or function performed; and cost center or job on which performed.

1. The first item of the code is the identification of the fund concerned. The Authority is required to maintain various types of funds, first as to bondholders—i.e., those related to General and Refunding Bonds, to Airport Bonds, and to Marine Terminal Bonds—and second as to whether they are operating funds, capital funds, reserve funds, sinking funds, or special funds. Because of these fund requirements, its first concern is with the balancing of funds and the proper charge or credit of expenses and revenues to such funds.
2. The second position in the code determines whether the item relates to an operating facility (the business enterprises of the Authority), to a facility being planned, financed and constructed (capital project), or to one of the general administrative accounts.
3. Thirdly, the code indicates that organization unit which is responsible for the revenue or expenditure concerned and which serves as the center for recording it.
4. Next is shown the specific type of work or activity concerned. As previously noted, one of the basic differences between responsibility accounting and the usual type of accounting is the elimination of so-called "object" breakdowns. Instead, this classification defines the kind or type of work (skills) performed by the organization unit, including, for example, administration, policing, building maintenance, paving, snow and ice removal, etc. Salaries, telephone expense, rent or stationery, are not shown separately. Rather, these are all combined and the total expense is related to the activity and to the unit's budget allowance.
5. At those facilities for which comprehensive cost accounting records are maintained, three types of cost centers were established. These serve as centers for the accumulation of construction costs and for recording all facility expenditures. At each such facility there is first a geographical segregation of the various segments, secondly, the establishment of various systems, and, thirdly, the establishment of the various services furnished. The first type includes, at an airport, the public aircraft facilities (the landing area, the ramp and apron area, the taxiways, and the required land adjacent thereto for safe operation), the automobile parking space, the air terminal highways, etc. Each building is considered a separate area and includes the land beneath it. The second type of area includes the electrical distribution system, the storm and sanitary sewer system, etc., with no land involved. The third type includes those services which the Port Authority is obliged to furnish, usually on a cost basis, such as porter service, Federal inspection service, etc.
6. The sixth category used at certain of the facilities is reserved for job numbers. This classification is used to provide operating cost data, for accumulating reimbursable cost data, establishing work standards, and the like.

Thus, all expenditures are identified first as to the fund concerned, second as to the facility or project concerned, third as to the organization unit involved, fourth as to the activity, and finally as to the area or as to the job involved.

Time Reporting

Time reporting is a basic tool of the accounting system. A bi-weekly time report is prepared for each employee of the Authority. This furnishes the Accounting Division with the information required each pay period to distribute payroll costs to activity accounts and to establish proper cost records.

Coding of time is based upon the chart of activity accounts established for each organization unit and the list of areas or job numbers used by the facility or department at which or for which the work is done. In the field units, normally nothing under one hour will be identified. In the administrative units it is normal for the time pattern to be consistent week after week.

When these individual time reports are received in the Accounting Division, they are factored for retirement cost and for authorized absence (holidays, vacation, sick time) so that effective payroll costs are charged to the applicable accounts each month. Time reports are important since the Authority is primarily a furnisher of facilities, and a service organization. It produces no goods, handles no large inventories, and payroll is the principal item of each organization unit's normal expenses. Voucher disbursements and journal vouchers are handled in their normal manner as to identifying the nature of expenditure.

Expense Allocation to Facilities and Projects

Wherever practical, expenses of the Port Authority are identified with and charged directly to each operating facility or capital project. However, in dealing with certain expenses of a general or overhead nature, it is necessary to accumulate them and to resort to various methods of proration or allocation to distribute them to each facility or project.

After each month's books have been closed and the trial balances taken, the following information is available:

The direct expenses of each facility or project
The indirect expenses of the Authority

It then becomes necessary to distribute certain of the direct and the indirect expenses to each facility and project. The Authority segregates three types of expenses which must be so handled:

Prorated direct expenses
Administrative expenses
Development expenses

The Authority operates various types of facilities—bridges, tunnels, airports, marine terminals, freight terminals, etc. Rather than have each individual facility act as a separate entity, the general supervision, promotion, planning and operation of each group of similar or related facilities such as airports is handled by specialized departments. For example, there is a General Superintendent of Bridges and Tunnels whose expenses are charged only to the six bridges and tunnels; and there is a General Superintendent of Airports who is charged only to the four airports. Their functions, which are performed centrally, would otherwise have to be performed directly at each facility. Accordingly they are in the nature of direct facility expenses although they become facility operating expenses through being prorated to the facilities benefited. This type of management is considered more efficient and less costly per facility than if each were staffed to be a self-contained operation. Naturally, the cost of each such specialized group serving more than a single operating facility is related only to those facilities with which it is concerned, and its expenses are therefore distributed only to that group of facilities as prorated direct expenses.

On the other hand, administrative expense includes the provision of common general and administrative services for the benefit of the Authority as a whole—both operating facilities and capital projects. Inasmuch as the entire Authority is located in an area within a radius of 25 miles from its administrative offices, the natural result is a

high degree of centralization of such administrative work (accounting, legal, medical, personnel, etc.) much of which, under normal corporate/subsidiary or divisional relationships, would reside in and be a direct expense of each such subsidiary or division. Because of this physical fact, the Authority is able, for example, to handle a large volume of accounting work with a relatively smaller staff, since the same group of people handles bridge, tunnel, airport, grain terminal, truck and bus terminal accounting. Within this group, naturally, certain key personnel are specialists in each of the types of facilities. This makes for over-all efficiency and helps to eliminate work-load peaks and valleys of segregated groups. Here, as in any company, such expenses are not capable of being specifically identifiable to any particular operating facility or capital project and are therefore allocated to each.

The other category of Authority overhead is development expense. This activity concerns work incurred for the benefit of the Port District as a whole, rather than of the individual facilities, and it is a task which has been assigned to the Authority by the legislatures of both States. It concerns the protection, development, and better conduct of commerce, intervention in proceedings affecting the commerce of the port, representing the District before the I.C.C., the C.A.A., Maritime Commission, and other state and government agencies in connection with rates, transportation problems, physical improvements, etc. This work has been assigned but it can only be carried out if the Authority has net revenues available.

Obviously, the activities represented by prorated direct, allocated and development expenses are necessary functions and the latter two are not pure overhead, but are so termed for convenience and economy in handling and accounting. They arise primarily out of the centralized nature of the Port Authority's organization and its operations within a small compact geographical space. If each of the facilities were a separate unrelated entity, each would require all of the functions and activities of the Port Authority—executive, accounting, fiscal, legal, medical, personnel, public relations, purchasing, research and development, etc.—and the expenses of these functions and activities would therefore be direct expenses of each individual facility at greater over-all cost and lesser efficiency.

Methods of Allocation

Prorated direct and general administrative expenses are allocated to each individual facility in the proportion that each facility's budgeted payroll bears to the total budgeted payroll for all facilities or for the group of facilities concerned. Payroll is used as the basis for distribution because it is the largest single item of operating expenditures. It is a broad base which is applicable to all facilities, and it is a reasonable indication of the effort and the size of the facility being administered. Budgeted payroll is used as a measure of the planned activity for which the central organization is staffed. Experience has shown that it introduces little distortion as compared with actual payroll since the variation between budgeted and actual payroll is slight. Accordingly, distribution of these expenses in this manner is a practicable way of charging for services rendered in proportion to the benefits received since unit staffing and unit plans are based upon the broad plans which are reflected in the annual budgets.

Since port development and protection are functions which can only be performed if there are sufficient revenues available above operating expenses, development expenses are allocated to facilities on the basis of net revenues, that is, on the basis of their ability to pay for these services.

Having distributed these expenses to each facility following sound accounting practices as developed in the Manual of Accounts, the Accounting Division is

able to prepare its monthly financial reports, one of which is a statement of the monthly expenses of the Authority by individual facilities. This is where airport *cost* accounting begins.

Airport Cost Accounting

The primary aim of the Port Authority airport cost accounting system is to inform the management of what it costs to provide physical facilities and services at each airport. This can be done in many ways and the detail in which cost records for an airport are kept could vary all the way from a detailed system having complete records as to each individual item of material, man-hours, etc., expended for each runway, structure and utility system, to a greatly simplified system in which all airport costs were simply lumped together as a total. The first extreme would be cumbersome and its costs of maintenance out of proportion to the value of the information produced; and the second would, of course, be valueless from the standpoint of management control.

So the Authority system has been designed to provide a reasonable maximum of information to the management for the purpose of planning and controlling expenditures; comparing the relative operating efficiency of similar facilities; measuring the effectiveness of rates and tariffs; and, in certain cases, actually setting rates, rentals and tariffs to be charged for the use of various specified areas and services, where such rates are required to be based upon cost.

To do this, it was necessary to determine for what specific areas and services costs were necessary and desirable at each airport. These areas and services were identified and costs were accumulated for them. As noted above, such cost centers* represent geographical areas, some of which are revenue-producing, such as the landing area, and some of which are non-revenue-producing such as the emergency equipment storage garage; the various utility systems, such as the electric and drainage systems; and services such as sky caps and incineration. A "general" cost center is provided for expenses not applicable to one of the specific areas or systems.

Expense Distribution at the Airport

At the airport level, all expenses are either direct or indirect expenses. Direct expenditures (e.g., labor, materials) are those which can be identified as applicable to a specific area or system and thus charged to that cost center. All other expenses (indirect) are those which cannot be so identified without an undue amount of arbitrariness and are, therefore, charged to the "general area" cost center. These latter expenses include such things as idle time of working forces, and supervisory expenses such as the office of the Superintendent. Similarly, the "general" cost center is charged initially with the total of all prorated direct, allocated, and development expenses charged to the particular airport, since these are, of necessity, indirect expenses so far as the individual area cost centers are concerned.

Port Authority cost accounting for an airport, therefore has as its major objective the determination of costs by revenue-producing cost centers in accordance with Port Authority policy. The procedure is to collect direct costs by cost centers from time reports, disbursement vouchers and journal entries. The monthly cost ledger is an analysis of each expenditure activity account by area or job distribution on a large spread sheet. Monthly and cumulative cost ledger balances will be carried on IBM cards punched from these monthly ledgers. Each month's direct costs are supported by ledger sheets backed up by

- Analysis sheets of each activity ledger account summarizing the area charges, and
- Monthly cost accounting journal entries giving effect to the distribution of segregated "ease and economy" charges, as explained below.

* See Appendix.

Direct airport expenses are those incurred *at* or *for* the airport, which are specifically for its benefit and can be so identified. They naturally include the payroll and other expenses of the four organization units located at the airport under the airport Superintendent's jurisdiction:

Superintendent's office
Security Section
Operations Section
Maintenance Section

as well as specific expenses incurred by other organization units of the Authority for that airport including:

Purchase and Special Services—Stores Section
Office of Real Estate Director
Concessions and Revenue Department
Insurance and Claims Division—Audit and Control
Treasury Department
Division of Central Maintenance

Indirect Expenses

While being direct airport expenses, such expenses may or may not be directly identifiable to one of the airport cost centers (areas). Runway repairs or building painting can be charged to a specific area. Expenses of the Superintendent's office, the Police Supervisor and similar items, cannot be, and accordingly special cost accounting treatment is required for them. As previously noted, those expenses which are not identifiable with a specific cost center are known at the airport level as indirect expenses and are charged to the General Area cost collection center.

Ease and Economy Treatment

The Authority has adapted and expanded a technique it terms "ease and economy of administration costing" of direct expenses. Briefly, this covers the treatment of charges which could normally be broken down daily in the field —but which cover a consistent pattern, thereby making it possible to obtain substantially the same distribution to the cost centers affected by charging a single classification in the field and having the Cost Division make a single monthly journal entry in the head office.

By this procedure, each classification of which is periodically checked in the field, it is possible to hold field and office clerical work related thereto, to a minimum—which means less clerks in the field, less payroll distribution, less general ledger machine postings. For example, if a police post is manned 24 hours a day by various individual policemen, rather than have each report exact hours on his daily time report, since the posts policed and the cost centers benefited are known, the time and cost is allocated accurately each month by the Cost Division. This saves many entries, extensions and postings.

Fixed Charges

The final item of airport expense consists of Fixed Charges (depreciation and interest), that is the recovery of Port Authority Investment of funds plus its interest cost on these funds. These are computed on the basis of monthly additions to completed construction, financed by Port Authority disbursement of funds (irrespective of source) using the equal annual payment method at the average interest rate and the average service life of property or term of leasehold, whichever is shorter. They are, in effect, direct cost center charges since they are applicable solely thereto in each case. Fixed charges are a sizeable portion of airport expense—at December 31, 1949, at New York International Airport for example, they were at the annual rate of $1,000,000 or 40% of the total airport expense.

Allocation of Systems and Non-Revenue Area Expenses

The sum of all the charges to the specific cost centers, together with the charges to the "general" cost center, constitute the total cost of operating the airport. All of these costs are proper charges against the revenues of the airport. However, the airport provides many services and has areas which do not, in themselves, produce revenue, and those portions of the airport's operation which do produce rev-

enues must pay for those that do not, and also for the airport's share of the general Port Authority overhead. For this reason, and in order to relate costs to revenues, it becomes necessary to distribute the costs accumulated for the centers that do not produce revenues (non-revenue-producing areas, systems cost centers, and "general" cost centers) to the revenue-producing cost centers.

The expenses charged to the "general area" cost center are first distributed to the various "area", "system" and "service" cost centers. Then, the expenses charged to the systems (utility and highways) are distributed to the geographical areas (both revenue-producing and non-revenue-producing) on the basis of actual area in square feet. The final step is the distribution of all expenses charged to the non-revenue-producing areas to the revenue-producing areas. Thus it will be seen that all expenses of and to the airport are eventually charged to areas that produce, or are capable of producing, the gross revenues with which they must be paid.

There are several possible methods for effecting these distributions. The methods adopted and used by the Port Authority resulted from considerable research, testing, and study of many methods by the Comptroller's office in conjunction with personnel of the operating and development departments, and by its public accountants. They are believed appropriate; they are in accordance with recognized and generally accepted cost accounting principles and methods, and they have been reduced to writing in a series of numbered instructions. Unlike most large industrial corporations, payroll is the largest single item in Port Authority expenses, and this fact naturally affected many decisions.

In one sense, all expenses except the direct expenses of the revenue-producing areas can be considered "overhead" as related to these areas. However, it will have been seen that many of these expenses are direct costs of operating other areas and systems of the airport and of the general airport management. And, as stated before, even the overhead charged to the facility "from above" represents no more than its share of the cost of services which the facility would otherwise have to provide for itself; and is part of the day-by-day planning, improving, expanding, operating and maintaining Port Authority facilities as going "businesses".

Cost Reports and Statements

Through this cost accounting system, there is developed for each airport, complete cost data on a continuing basis which provides for each revenue-producing area, periodic statements of:

- its direct operating and maintenance expenses,
- its share of field level general expenses,
- its share of prorated direct, allocated and development expenses,
- depreciation including interest applicable to the area based on Port Authority capital funds invested therein, and
- its share of the cost of systems and non-revenue producing areas.

Each year, for the six months period ended June 30th and the twelve months period ended December 31st, area cost statements for the airport facilities are issued for management use. This information is most useful in reviewing operations and deciding upon policy. At one airport, for example, during one such period the ratio of all other charges to direct revenue-producing area charges has varied from 66% to 228% for different areas. That is, for each direct-to-an-area dollar, 66¢ to $2.28 must be added to arrive at the total to be charged against that area.

Treatment of Revenues

Revenues are accumulated by source (through use of activity accounts assigned to the organization unit having responsibility and supervision therefor) and by the revenue producing area to which they are applicable. With this information it is possible to produce statements of the gross revenue, the

total expenses, and the net margin of revenue or deficit for each revenue producing area. Such statements are used by management in its detailed review of airport operations, as a yardstick in evaluating the adequacy of current rates and tariffs, and in maintaining a cumulative record of development losses.

General Comments on Cost Accounting Methods

In any cost accounting system, there are various possible methods available for allocating indirect or general costs. It has always been recognized that there are differences of opinion as to methods of allocating indirect expenses. They existed among the Authority's staff, they exist between accountants, and they exist between companies. There is no only way nor one best way. The methods that the Port Authority has adopted have resulted from policy decisions following careful, conscientious consideration. Through their use it is able to determine a net operating result for each revenue-producing area. Whatever expense is charged to each airport has to be distributed somewhere at the airport. Whatever methods are used will indicate those cost centers which produce a margin of revenue over expenditures and those which do not.

The Authority recognizes that cost accounting techniques are not static, and while it believes the degree of error between well-reasoned methods is small, it continues to study new methods and will adopt any that appear to be justified. However, having arrived at its present practice and procedure after due deliberation, it is believed preferable not to make any changes except where there is some impellng demonstrable reason since there is considerable virtue in consistent year by year treatment and comparisons.

No cost system is any better than the basic data developed by those responsible for accounting for direct hours of time and direct dollars of expenditure. Consequently, it is necessary that the cost accountants maintain a continuing and close liaison with the various facility organization unit heads, chief clerks, and superintendents. In addition a Classification Supervisor is constantly talking with and advising the field and administrative units as to account coding problems.

An accounting system is not static—it is continually expanding and contracting as recurring and nonrecurring needs arise. That of the Authority is flexible enough to record, in addition to its regular accounting, the costs of unusual occurences such as, for example, those incurred as a result of the May, 1949, Holland Tunnel explosion and fire damage—for use in explaining variations from previous years, from budget, and for insurance and damage claims purposes.

Actual cost may be determined only where a concern makes one product or provides one service, and even there, there must be allocations to periods of time. Where more than one product or service is involved, a cost system must make use of appropriate allocations, prorations and distributions based upon policy decisions, and in accordance with generally accepted cost accounting principles. The results represent an honest effort at cost determination.

Naturally, the Authority does not have all the answers. It is trying to solve its problems of airport operation, and related accounting requirements in a consistent manner and in accordance with sound accounting practice. The Port of New York Authority believes in the future of air transportation, and in the principle that airports can be self-supporting through proper planning and operation and through the development of all possible sources of revenue from commercial, service and recreational facilities for airline passengers, employees and visitors. It is anticipated that peripheral development of each airport will provide a major contribution towards making the airport self-supporting.

The airport problem is unique in that capital expenditures required early in the development stage produce the least immediate revenues. An airport is like a city development. It must be laid out. Underground utilities, drainage, sewers, highways, fire protection, etc., must be provided. Then as the activity develops, an increasing return is produced on this development investment. Such a result is making itself evident, and it it anticipated this trend will continue.

Appendix

Representative Bases of Making Expense Distributions:

budgeted annual payroll
net operating revenues
capital investment
square feet of land area
insured values
cost center proportion of total activity account expense
telephone outlets
washrooms, number of fixtures
total expense, including all previous distributions, but exclusive of items to be distributed.

Representative Service Lives by Airport Cost Center and Type of Property:

Terminal Building	— Land	50 yrs.
	Concrete & Masonry	30 yrs.
	Steel Frame and Sheeting	30 yrs.
	Concession Equipment	5 yrs.
Public Aircraft Facilities	— Paving—concrete	30 yrs.
	Field Lighting	20 yrs.
Electrical Distribution System	— Underground Ducts and Cables	40 yrs.
	Substations	20 yrs.
Air Terminal Highways	— Street & Highway Lighting	20 yrs.

Investment in land arises by purchase acquisition and by improvements to land such as filling and grading, soil stabilization, demolition and relocation of structures, boring and tests, perimeter fencing, dredging, marginal dykes, etc. Such expenditures are combined as one investment cost and the periodic fixed charges thereon are distributed to the airport's geographic areas on a square foot basis.

New York International Airport Areas (Cost Centers):

For purposes of Cost Accounting, every General Accounting *expenditure or revenue activity account* entry originating from a time report, journal voucher, disbursement voucher or cash receipt is further identified to specific cost centers (areas) by use of area number. Where an expenditure cannot be identified solely to a specific cost center, it is entered in a separate area designated General Area.

General	101 General Area	—
	150 Privilege Permits	R
Systems	201 Communication and Signal System	S
	202 Electric Distribution System	S
	203 Gas Distribution System	S
	204 Storm and Sanitary Sewer System	S
	205 Water Distribution System	S
	210 Aircraft Fuel Storage Area	R
Services	212 Public Incineration Service	R
	213 Skycap Service	R
	215 Ground Transportation Area	R
	216 Federal Inspection Service	R
	217 U. S. Mail Space Service (AMF)	R
	220 Electrical Submetering Service	R

Land and Improvements to Land	310	Field Service Roads System	NR
	311	Public Landing Area	R
	313	Public Aircraft Parking & Storage Area	R
	314	Public Air Terminal Highways System	S
	317	Public Vehicular Parking Area	R
	331	Paved Land Area	R
	332	Unpaved Land Area	R
Site Areas	351	Federal Building	R
	356	Private Dwellings	R
	357	Drive-In Motion Picture Theatre	R
Pier and Waterfront	521	Approach Lighting Pier Area	R
Building Site Areas	602	P. A. Field Offices & Garage	NR
	608	Storage and Maintenance Garages	NR
	609	Automobile Service Station Area	R
	610	Terminal Bldg. Area—Permanent	
	611	Terminal Bldg. Area—Temporary	R
	612	Bldg. No. 105—Emergency Service Garage	NR
	614	Bldg. No. 104—Air Cargo Bldg. Area	R
	621	Hangar #1	R
	622	Hangar #2	R
	623	East and West Lean-to—Hangar #1	R
	624	East and West Lean-to—Hangar #2	R
	629	Observation Deck Area	R
	630	Bldg. No. 107, 119—Commissary—Air France	R
	631	Bldg. No. 106—Mobile Commissary—Nationwide	R
	632	Bldg. No. 152—Commissary—KLM	R
	634	Bldg. No. 162—Operations—Cargo	R
	640	Green Bus Lines Bldgs.	R
	650	West Edge—Hangar #3	R
	651	Hangar #3	R
	652	West Center—Hangars #3 and #4	R
	653	Hangar #4	R
	654	East Center—Hangars #4 and #5	R
	655	Hangar #5	R
	656	East Edge—Hangar #5	R
	670	Bldg. No. 156—Sanitary Disposal	R
	671	Fuel Storage Garage	R

R Revenue Producing
NR Non-Revenue Producing
S System

Cost Accounting in Air Transportation

By Raymond G. Lochiel

My remarks in this paper will be related to the application of cost accounting to the air transportation industry. Most people think of air transportation in terms of airplanes and pilots without any realization of the size of the organizations which support those visual evidences of the business and with only a vague idea of how large the industry has become. In order that you may better understand the scope of the industry as it relates to cost accounting, I would like to describe briefly the domestic air transport industry as it is today.

The sixteen certificated interstate trunklines, comprising the major part of the domestic air transport industry, grossed $500,000,000 in operating revenues in 1949 and, at the end of the year, employed 55,000 people. These carriers operated 437 two-engined and 275 four-engined aircraft and carried 14,000,000 passengers a total of 6,600,000,000 revenue passenger miles. My company, Capital Airlines, ranks sixth in size among these trunkline carriers. As you can see, air transportation now compares favorably as one of the major industries of our country and this growth has largely been achieved in the last decade.

Raymond G. Lochiel is Vice President and Treasurer of Capital Airlines, Inc. He has specialized in aviation finance and accounting for over 20 years.

Mr. Lochiel is a National Director of the National Association of Cost Accountants, President of the District of Columbia Control of the Controllers Institute of America, and Second Vice President of the Airline Finance and Accounting Conference of the Air Transport Association.

This paper was presented by Mr. Lochiel at a recent meeting of the Rochester, N. Y., chapter of the N.A.C.A.

It is this rapid rate of growth in relatively recent times which is responsible for the fact that airline cost accounting is still in its developmental and experimental stage, despite the present size of the industry. Before the war, even the biggest carriers were small by comparison with today. The companies were relatively simple in organization and the administrative problems of controlling costs were not so involved. During the war, military contract operations together with rapid growth brought to airline management an increasing awareness of the need for more formal cost accounting procedures and controls, and the uncomfortable realization that the growth in size and complexity of the companies made such action imperative. It was during this war period and the turbulent financially difficult period immediately following, that cost accounting and the importance of the cost accountant were properly recognized and came into their own in a substantial way in our industry. At this time, when for very many reasons the economic machine of the airlines seemed to have stalled and progress, temporarily at least, seemed to have stopped, it was very important that we recognize the fundamental truth that over 150 years of industrial development should have deeply etched in our minds: There is no royal road to economic progress except through cost control.

The solution to the airline cost accounting problems might have been simple and quick if we could have borrowed in whole the already well-charted cost accounting approaches of manufacturing industries. Unfortunately, we could not do so—all we could

do was to take the principles of cost accounting and fashion from them a system which would suit our peculiarities. Each company worked more or less independently of the others in solving a common problem. Accordingly, there are no two companies which have taken exactly the same approach or have achieved identical degrees of progress towards the final goal of complete cost control. The peculiarities of our industry which have made it impossible to use the systems developed by other industries are interesting and present a challenge which any cost accountant will be quick to recognize. I want to describe them in some detail.

Perishable Inventory

One of the chief characteristics of our industry is the highly perishable nature of our product. This product is basically space-weight in motion and is called an available ton-mile. When one of our Lockheed Constellations leaves Washington on a non-stop trip to Chicago, it "manufactures" 6,000 available ton-miles. They must be sold prior to departure from Washington or they will never be sold at all. Assuming the production of 6,000 available ton-miles on a Washington-Chicago Constellation trip, suppose that at departure time only one-third of these available ton-miles are sold. We are in the odd position of being forced to manufacture all 6,000 of them in order to sell the 2,000 which are booked at departure time. This is because production control cannot be administered in fine detail in our business, but only on a broad over-all basis. We have nothing left, after a partially filled airplane departs, which we can put on the shelf and hold for future demand, or perhaps sell at an attractive sale price. We, likewise, cannot wait until a few minutes before flight time and then offer the remaining unsold space at an attractive discount. We are simply "stuck" with the production cost of the unsold space which does not have even a scrap value.

This airplane is an expensive piece of mechanical equipment to operate—it burns 350 gallons of gasoline each hour it flies. It is designed to lift and fly a certain gross weight. It costs a certain amount to lift and fly each pound. A Constellation fully loaded for a 1,000 mile flight will have a gross weight of 90,000 pounds. The available payload represents 21,000 pounds, or 23% of the total weight which must be lifted and flown. Each pound of the weight of the airplane such as mechanical equipment, radio, gasoline, etc., represents to us a cost to lift and fly which in turn reduces the amount of payload we can offer for sale. Accordingly the nature of our product and productive machinery provides a limitation on our initiative in tailoring production and production costs to demand for our product.

Short Economic Life of Equipment

The machine which produces our product is also a factor in limiting our initiative in cost control which must be understood. Our business does not require extensive real estate or buildings on or in which to house our main productive machinery. The machine or airplane is, however, a tremendously expensive piece of equipment and its useful life is relatively short. Modern 4-engined aircraft cost from $1,000,000 to $1,750,000 each to purchase, and yet their useful lives of seven years are very short by comparison with the 25 to 30 years which is common in railroad rolling stock and much heavy manufacturing machinery. Because of the rapid rate of design and technilogical development, transport aircraft experience rather rapid economic obsolescence. Due to the standards and methods of aircraft maintenance, there is no perceptible physical obsolescence. Worn parts are regularly replaced by new ones. However, newer, faster, more comfortable aircraft force older

and less modern designs out of the competitive picture and render them just as obsolete as though they were physically worn out. An airplane five or ten years old, operated and maintained by one of the certificated trunkline carriers I previously mentioned, will be in as good condition as when it was first purchased from the manufacturer.

Generally, the industry has established about seven years as being the period of usefulness and, accordingly, is the depreciation span in today's air transports. This is a relatively short time in which to recover the investment in a piece of equipment worth perhaps $1,000,000, pay its operating costs and earn a reasonable profit. The need for cost control is made acute by this combination of factors and becomes even more acute when it is realized that on the average, a 65% or 70% payload factor the year round is about the maximum that can be reached in normally competitive circumstances and load factors generally range between 50% and 60%. In other words, the expenses, investments and profit must all be returned over a rather short life span out of considerably less than total capacity. To achieve financial stability and success with an economic riddle like this requires rather intimate knowledge of cost behavior.

Preventive Maintenance

The cost of maintaining aircraft in perfect flying condition is one of the most substantial elements of airline costs, generally from 18 to 20 cents of every expense dollar go into maintenance of equipment. In 1949 for example, the domestic trunklines spent more than $83,000,000 in the maintenance of their equipment. No expense and no effort is *ever* spared to improve the technical performance and safety of airline aircraft.

The goal of airline maintenance is not to repair breakdowns but rather to prevent breakdowns from occurring. It is performed according to a prearranged and carefully planned schedule of what we call maintenance inspections and overhauls. These occur at regular intervals, measured in terms of flying hours elapsed, on every part of the aircraft. They occur even though there is no evidence of trouble. In addition, a maintenance inspection is required each time an airplane completes its scheduled trip and is turned around to make the return trip and, also, each night when the airplane has completed its day's work. If airline maintenance expense were limited purely to repairing structures and parts when their condition warranted repair, our costs in terms of operating expense would be a great deal lower than they are, but we probably could not point with as much pride to our record for safety and dependability. We in the air transport industry strive to preserve quality and safety for you—our customers. I hesitate to hazard a guess as to the amount spent to make our product safe, as such program does not lend itself to exact analysis. From a cost accounting point of view, airline maintenance appears very expensive. It may seem inefficient to completely overhaul aircraft engines, for example, every 1,000 hours of operation if the engine is operating perfectly at the end of this time cycle. Whatever it may seem to be, it is done and will continue to be done at stated intervals, and the airline cost accountant is no more interested in modifying this fixed policy than is any other airline man.

The preventive character of airline maintenance and the increasing complexity of aircraft do, however, place a restriction on the initiative of management with respect to a considerable portion of the operating costs.

Public Service Industry

Another characteristic of airlines which limits the elasticity of cost management is the fact that we are a highly regulated common carrier industry. We are certificated to provide public transportation services to various communi-

ties and we must provide it whether or not the traffic volume generated by a particular community justifies it economically. Our rates are likewise regulated. We do not have complete freedom to change our rates as the notion strikes us, and generally the rates have not been sufficiently sensitive to the costs of production. To increase our volume—to provide mass transportation—we must continue to lower our rates. To lower our rates we must lower our cost through more efficient methods of operation and yet provide a reasonable profit margin. The profit margin concept is, I believe, in harmony with the manufacturing industry. In the interest of low selling price to create a broad market, profits per unit of product should be reasonably low, and industry should look to high volume of business activity for an adequate return on the capital invested. Greater profits from higher prices can be made for only a short period, but eventually competition will overtake the higher priced industries; or the more potent force of the consumer against the higher prices will curtail sales volume to the point where the lowered volume becomes inadequate to return any profit. It can, therefore, be readily seen that air transportation is a virgin field for creative thinking by cost accountants.

High Degree of Fixed Cost

The common conception of airline costs is that they are mostly variable in character and rise and fall as the volume of aircraft operation rises and falls. This is an impression which is not uncommon within the industry itself. There has been a tendency, when reduced winter schedules are put into effect, to sit back and watch the expenses fall. Unfortunately, the amount of airline expenses which respond automatically to declines in volume of service and sales is disappointing in terms of the total expense level. I would say that 20% to 25% of the expense level is about all that has an automatic response.

One big reason for this is the fact that approximately one-half of airline expenses are payroll costs and payroll does not decline automatically—it has to be pushed down. It requires an alert cost accountant with initiative and creative thinking to point the way. Another reason is that a surprisingly large part of airline expenses is comprised of esentially fixed costs, such as insurance, rentals for traffic and operating facilities in the numerous cities served, long-term leases on communications facilities and installations, maintenance and headquarters facility rentals and depreciation. Only substantial changes in the size and character of the airline permit changes in the cost levels of such elements. They are certainly not subject to short-run seasonal economies.

The trend toward greater unionization of airline personnel has likewise made payroll costs much less susceptible of reduction in short-run seasonal traffic declines.

These five characteristics of airlines, namely: (1) perishable inventory, (2) short economic life of equipment, (3) preventive nature of maintenance, (4) public service aspects of industry, and (5) high degree of fixed costs, all combine to present the airline cost accountant with a challenge and a handicap at the same time. Sometimes one wonders that profits are achieved at all. There are, however, compensating bright spots; one is the tremendous profit leverage that exists in the big 4-engined aircraft once their load factors rise above the breakeven point and that breakeven points are reasonably low, in 1949 generally in the area of 50% to 55%. Our own was 44%.

I would like now to discuss some of the practical steps of cost control which are used. In this discussion I will describe steps followed by my company. Earlier I mentioned that cost development had reached varying stages in the individual companies. I am using Capital because we know we are in the forefront; however, many of the steps I will describe are also in use in some-

what similar form in most of the large carriers.

Before discussing the steps we follow, I think it is appropriate to spend a moment talking about how our cost accountants fit into the picture. All of our cost work ends up in the form of a management report or rather a number of management reports. Too frequently, the cost accountant has finished his participation in cost control when he has made his reports available to management. This is not the case in our organization. Our cost accountants are trained and expected to work with the operating departments on a day-in and day-out basis. They are taught that their contacts must be close, friendly and always helpful. They are trained to use their own initiative in putting across the significant points of issue which are developed in their reports. In other words, we do not believe in distributing cost information and then sitting back and waiting for something to happen. We follow up the reports aggressively, first to make sure they are understood and, second, to make sure that constructive action follows. This close contact and constant availability of the cost accountants has paid us well. During the period when problems are being considered, cost accountants should approach the problem with an open mind—rather than a skeptical one—willing to receive different opinions—different than his. After considering and weighing all the pertinent facts, he should, without delay, arrive at a well-balanced decision not tempered with appeasement. After making his decision he should take prompt, decisive action. Cost accountants to be successful cannot be intellectually lazy—they must think their problems out—then act. Only by such a method can cost accountants in any industry fulfill their obligation to their profession and to their companies. Management should encourage the cost accountants to fulfill this obligation. As I discuss individual reports in the next section, you should think of them against the background of aggressive "follow-up" which I have described.

Airplane Operating Costs

These largely incorporate the pilots' salaries and expenses and the fuel and oil costs. Pilots are limited to flying only 85 hours per month. If they are not scheduled very carefully, a close approach to this maximum is impossible and a larger complement is required. We analyze the utilization of pilots in detail each month to assure ourselves that the company is getting the highest practical utilization of each pilot.

With respect to gasoline and oil, we operate in 15 states and the District of Columbia. Fuel prices and taxes vary from one jurisdiction to another. The range in gasoline prices is from 15 to 30 cents and in taxes from 1½ cents to 8½ cents. Accordingly, it is extremely important that we take advantage of the lowest prices wherever possible. A price differential of one cent per gallon is of considerable importance when you think in terms of fueling a Constellation with 2,000 or 3,000 gallons of gasoline. Our company alone burns up some 2,000,000 gallons in an average month. Our approach to controlling costs of fuel has involved the placing of fuel price schedules in each pilot's manual and in the hands of each flight dispatcher. Beyond this we issue periodic reports to the Operations Department showing in considerable detail the record of fuel servicing and pointing out the ways in which alternative service patterns may have saved money. These two approaches have been very successful in their effect on the average price of fuel consumed. This is one example of how an alert cost accountant can demonstrate his importance to his company.

Airplane Maintenance Costs

I have described previously the preventive and strictly periodic character of airplane maintenance. Safety is the first consideration and cost controls ap-

plied to this point are used very carefully to prevent the slightest conflict with the primary goal.

In part, our maintenance operation may be likened to a production line. This applies to the disassembly, overhaul and reassembly of engines and power plant accessories. The various steps involved have been broken up into logical operations which are clearly defined, and we accumulate the total costs of performing each operation against the number of items handled each month to develop standards. Costs per unit handled in terms of dollars and cents and also in labor hours and minutes are then computed and reports are issued monthly to shop supervisors as well as to top maintenance management. Comparisons with past records are made and trends charted against a six-month moving average. These reports have effectively red-flagged undesirable trends in production costs, and the individuals supervising such red-flagged operations are required to investigate and report fully the reasons therefor. In our particular case we have not only made constructive strides in reducing the unit cost of individual production line operations but have seen a gratifying improvement in the supervisor's interest in and knowledge of his production problems.

A large part of maintenance operations, however, may be characterized as custom repair and each individual operation differs in some respect from every other. Here it has not been possible to measure and compare in fine detail. In order to achieve any kind of comparability, operations have to be taken in rather large combinations. This, of course, makes the problem of pinning down variances from past experience impossible in most instances. We can and do study these combinations of operations in an effort to reduce the obvious causes of wasted manpower. Mechanized tools are provided wherever practicable. Huge specially designed jigs with catwalks are also put in place around each airpalne in maintenance to reduce the time lost by men moving about in the course of their work. As much as possible, we have eliminated the need for high-paid mechanics to go looking for tools or materials.

Hostesses and Passenger Service

As in the case of the pilots, the hostesses are limited in the number of duty-hours per month. Here again, airplane schedules and hostess complements are carefully analyzed to achieve as near maximum utilization of the time of each hostess as is practical. Monthly hostess utilization reports are issued.

In addition to hostess salaries, there is another major element of controllable cost in the passenger service function—that is food for passengers. This is a point at which cost control must be exercised, generally the wastage of food has been high because of over-ordering of meals by company personnel. We, for example, have catering arrangements at about a dozen cities on our system. Each of such stations is responsible for ordering food for certain specific flights. These orders are supposed to be based upon passengers booked for travel on the food-serving segment of the flight.

Each month we reconcile caterers report of meals delivered to each flight with the actual record of paying passengers aboard at the time the meal is scheduled to be served. A monthly report is issued to management and catering points showing the number and percentage of excess meals ordered. Some excess is expected as normal, due to the fact that last-minute coordination between bookings and meal orders cannot be achieved because of the physical problems of boarding the food. There are also last-minute changes in passenger plans resulting in "no-shows" which contribute to such normal excess. However, when the excess exceeds the previously established normal standard, the individual responsible must explain why and, as a result, wastage of meals in our case has been reduced to and

kept at a very low level. Our own cost accountants designed and developed these cost reports and analyses from which a standard of efficiency was established. These cost accountants then worked with the operations department and developed methods and procedures which have effectively reduced this cost.

Station Operations and Sales

The personnel complements and facilities in the various cities we serve comprise a very substantial part of our expenses—approximately 20%. Since they are out from under the close physical supervision of headquarter's management, they must be watched very carefully from a cost viewpoint. The instrument used for this is a monthly station report which our cost accountants have designed, and which shows the revenues taken in at each staion, the direct expenses by category, and the station's contribution to system overhead. The latter is then allocated by a formula we have built up over many years, and a station profit and loss is computed. These revenue and cost data are then measured against such volume statistics as tickets used, airplane departures handled, passengers boarded, etc. Comparisons with previously established standards and prior periods are made and the report goes to all field and headquarters supervisors. This report is watched carefully for unfavorable trends and they are quickly investigated. Station supervisors are thus held strictly accountable for the efficient operation of their own small business.

Personnel Complements

Since half of our expense is payroll, we operate on strictly established complements for each location and function. The personnel complements are established on a carefully measured workload productivity basis. Adherence to such complement quotas is policed by daily reports of employment and termination activity and monthly summaries of the status at each location and of each function.

Schedule Preparation

Earlier in my remarks, in discussing the perishable quality of our product, I mentioned the impossibility of scheduling our production to demand in the way a manufacturing company does. In a broad fashion we do attempt to fit production to expected sales. Our production plan for a future period is what we call the airline schedule comprising the numerous trips to be operated in a future period which may run from one to several months. When a schedule is being prepared, the cost accountants play a constructive and influential part in its construction. Analyses of sales demand are made for the period under consideration and we then determine how many available ton-miles are going to be required to assure us of attaining the forecasted traffic volume.

The cost accountants, with their intimate knowledge of the breakeven points of various types of equipment and of various service patterns, can assist in selecting the type of service most likely to be profitable in each of the dozens of markets we serve. For example, they can tell the schedule experts on what services the larger 4-engined DC-4 or Constellation equipment is most likely to be profitable and when, due to a lower traffic density, the smaller twin-engined DC-3 aircraft are more appropriate. They can also advise on the past profitability of certain services which may be reinstated. They can advise on how trip service patterns (number of stops, time of day or night, etc.) may affect trip costs and consequently, profit margins. They can and do have the answers to a myriad of questions about the most economical combination of services to offer.

In such fashion, we prepare a schedule designed to secure for us the most traffic with the least mileage. Finding the exact key to this happy goal is probably an unattainable goal because of the hundreds of possible service com-

binations. Cost accounting has, however, largely removed the guess-work from scheduling and, as time goes on and the knowledge of the economics of service patterns becomes greater, the probability of success in each case increases.

This is not to say that we expect every schedule to make money. Because of our wide seasonal fluctuation in traffic volume, we have historically lost money in January and February and sometimes in March of each year. It is just as important for the cost accountant to advise on these winter schedules. An intelligently planned service pattern will enable us to make economies in the expense level in these depressed periods which might not be possible if the economic part of the schedule picture were ignored or made a side issue.

Budgets

Superimposed upon all of our cost reporting system, the principal parts of which I have described, is our variable budget system which has been developed over many years. We budget each item of expense for twelve months in advance, and adjust the variable elements of expense automatically as the level of production develops variances from the forecasted level. Fixed elements of cost are also changed as required; however, these are generally set by contractual arrangements or management policy and the adjustments are much less frequent. Our experience shows that all departments of the company have accepted budgeting as an aid and take a very satisfactory interest in compliance.

In closing, I wish to apologize for drawing so frequently on my company's approach to cost controls. As I said earlier, the stage of development varies from one company to another; however, what I have described is generally the frame-work followed by the major carriers.

The true test of a cost accounting program is the results that are achieved. Our business, in the years since 1945, has experienced the same increases in the prices of labor, materials and services which have characterized the whole American economy. It is against this background that I want to state for your information that Capital's cost of production of an available ton-mile was:

in 1946	33.54 cents
in 1947	31.15 cents
in 1948	30.34 cents
in 1949	28.14 cents
in the first eight months of 1950	26.74 cents

I hope that what I have said has been of interest as an insight into the cost problems of an industry which is not well known from this viewpoint.

Bibliography on Airport Accounting

Prepared by COMMITTEE ON AIR TRANSPORT AND AIRPORT ACCOUNTING

American City, *Putting Logic into Airport Accounting,* an intelligent analysis of airport revenues and expenses will go far in giving a true economic picture of this important municipal function; Feb. 1946, p. 72.

Bollinger, Lynn L., *Private vs. Public Management of Airports,* Harvard Business Review, V. 24, Summer 1946; p. 518-34.

Bollinger, Lynn L., Passen, Alan, and McElfresh, Robert E., *Unit Costs of Airport Physical Facilities,* (in their Terminal Airport Financing and Management), 1946; p. 346-73.

————, *Terminal Airport Financing and Management,* Harvard University Graduate School of Business Administration, Division of Research, Boston, Mass., 1946; p. 385.

Cunningham, Joseph M., *Balance Sheet Accounts for Airports,* Municipal Finance Officers Association of the United States and Canada, Chicago, Ill., Aug. 24, 1945; 13 p.

————, *Airport Accounts,* Municipal Finance Officers Association of the United States and Canada, Chicago, Ill., 1945; 28 p.

————, *Standard Accounts for Airports,* Journal of Accountancy, V. 81, March, 1946; p. 214-16.

————, *Revenue and Expense Accounts for Airports?* Municipal Finance Officers Association of the United States and Canada, Chicago, Ill., June 30, 1945; 27 p.

————, *Airport Accounting,* N.Y.C.P.A., V. 18, Feb., 1948; p. 139-140.

Dillon, Ralph Paul, *Selecting, Planning & Financing Sacramento's Municipal Airports,* American City, July, 1930; p. 105-6.

Duke, Donald, *Airports and Airways,* Ronald Press Co., New York, 1927; 178 p.

Ellenberger, I. W., *Airport Accounting,* Aviation Engineering, May, 1932; p. 51-53; July, 1932; p. 46.

Frederick, John H., *Airport Management,* Richard D. Owen, Inc., 1949.

Hartsfield, W. B., *Municipal Airports-Comptroller,* Aug., 1928; p. 25-8.

Hegardt, G. B., *Oakland Municipal Airport,* American City, May, 1929; p. 142-4.

International Civil Aviation Org., *Airport Economics, 1080 University St.,* Montreal, Canada.

Ireland, F., *Audit of Airport Authority Accounts,* Accountant, Oct. 29, 1938; p. 597-8.

Journal of Accountancy, *Accountants as Arbitrators,* (editorial) V. 83, June, 1947; p. 456-7.

Morgan, Walter L., *Auditing the Accounts of an Airport,* Journal of Accountancy, V. 49, Feb., 1930; p. 127-34.

————, *Accounting Management and Costs for Airports,* July-Sept., 1929; pp. 13-4, 46, 39, 55, 47-8, 63.

National Municipal Review, *Better Look Before You Fly—Communities Should Plan Before Building Airports,* June, 1949.

New Airport Account Methods Are Planned, Aviation Week, 47 :32, Dec. 22, 1947.

Parker, C. A., *Know Where Those Dollars Are,* Aviation, 1946; p. 45-49, April; p. 44-46, June; p. 80-1, July.

Pool, Robert M., *Municipal Airport Accounting,* Accounting Review, V. 23, Jan., 1948; p. 86-90.

————, *New Airport Manual Combines Municipal and Commercial Accounting Methods,* Journal of Accountancy, V. 87, Feb., 1949; p. 147-9.

Puffer, Claude E., *Airports,* (in his Air Transportation) 1941; p. 623-32.

Putnam, Lawson L. & Myers, Franklin D., *Accounting for Aviation Operators,* Airway Age, Mar.-Aug., 1930; pp. 348-52, 500-3, 660-4, 790-5, 941-3, 1067-71.

U. S. Civil Aeronautics Administration, *Airport Financial Statements,* Govt. Printing Office, Washington, D. C.; 1948; 41 p.

U. S. Dept. of Commerce, Department of Airport Operation, *Airport Operation,* in its opportunities for establishing new businesses in aviation; p. 16-29.

U. S. Dept. of Commerce, Civil Aeronautics Administration, *Airport Financial Statements,* 1948; 42 p.

——————, *Airport Accounting, Budgeting and Insurance,* Govt. Printing Office, Washington, D. C.; Jan., 1949; 35 p.

Warrender, Lee D., *Material Control in Chain Airport Operation,* Aviation Engineering, Feb., 1932; p. 37-8.

Wines, James P., *Airport on a Paying Basis,* Aviation, June 21, 1930; p. 1217-21.

—Sub-committee on Bibliography:

FREDERICK M. BRUELL

BERNARD WOLPERT

S. J. MARCONE, *Chairman.*

President's Message

(Continued from page 241)

counting is as opposed to other types of accounting work and if we are to dispel the impression that we are creating a monopoly. We need this for a firm foundation on which to build up sentiment in favor of a properly conceived regulatory bill.

The Legislative Committee went down, we might say, on March 15th for a count of nine but before a knockout could be registered it was on its feet again full of energy and determination ready to make plans for next year's battle.

We have no real cause to be disturbed or disheartened by the results of this year's legislative work. We could not have determined the position of those concerned in the regulation of professional accountancy in any other way. The preparation and introduction of a bill was necessary to bring out the facts. Expressions of good natured approval or of emotional opposition to the bill meant little, as the committee found out, until the test of an actual bill, actually introduced in the legislature, was made.

The Legislative Committee is still engaged in gathering information on which to formulate a policy to be submitted to the membership. The time and effort spent on legislative matters this year, while it has brought no positive result, has not been wasted. We know who our friends are and, while I hope and believe that we have no real enemies, we do know who has been and will be opposing us and on what grounds the opposition will rest. We are ready to continue the advance towards a proper legislative background for the profession of accountancy.

—MAURICE E. PELOUBET

Interdependent Deductions Under Federal and New York Taxes

By HERMAINE MEINHARDT

IN a note, similarly entitled, which appeared in the January, 1948, issue of the *Journal of Accountancy,* at page 69, Mr. Franklin C. Ellis provides a very handy formula for the solution of the following problem:

> Corporation "A" has net income of $100,000 before certain deductions, namely, (a) Federal income tax; (b) New York State franchise tax; and (c) a Bonus to certain employees.
>
> The bases for the computation of these deductions are as follows:
>
> (a) the Federal income tax is 38% of taxable income which, in turn, is equal to $100,000 plus unallowable tax deductions of $1,200 less the franchise tax and the bonus.
>
> (b) the New York State franchise tax is 4½% of taxable income plus the franchise tax for the current period and less the franchise tax for the prior year ($4,000).
>
> (c) the bonus is 20% of net corporate income, after deduction of current federal and state franchise taxes.

While Mr. Ellis' algebraic equation is very simple, its solution is quite difficult, since it requires a good working knowledge of algebra and involves long computations to nine decimal places.

There is also the trial-and-error method set forth in the 1950 Prentice-Hall Federal Tax Service (Volume III, Paragraph 27041), which is easy to understand but may involve ten to twenty trials before the correct answer is reached. Of course, the greater the number of trials, the greater the opportunity for error.

The writer offers another method herein whereby the solution may be reached by simple arithmetic, and only two trials are needed.

Preliminary Computations	Over	Under
Net Income, Before Bonus and Taxes	$100,000.00	$100,000.00
Plus: Deductions Unallowable for Tax Purposes	1,200.00	1,200.00
Total	$101,200.00	$101,200.00
Less: Bonus (@ 20%)—Two assumptions:		
May not be more than		21,000.00
May not be less than	1,000.00	
Tentative Basis for Taxes	$100,200.00	$ 80,200.00
Less: Franchise Tax (@ 4½%)—Computed up respective bases for taxes, after deduction of previous year's tax ($4,000)	4,329.00	3,429.00
Basis for Federal Tax	$ 95,871.00	$ 76,771.00
Less: Federal Tax (@ 38%)	36,430.98	29,172.98
	$ 59,440.02	$ 47,598.02
Less: Deductions Unallowable for Tax Purposes	1,200.00	1,200.00
Basis for Bonus	$ 58,240.02	$ 46,398.02
Bonus (@ 20%)	$ 11,648.00	$ 9,279.60
Bonus Assumptions—as above	1,000.00	21,000.00
Difference—over	$ 10,648.00	
Difference—under		$ 11,720.40
Total of over-and under-differences	$22,368.40	

Adjustment of Bonus Assumptions to Arrive at the Correct Bonus:

Let x equal the adjustment.

Then (1),
$$\frac{x}{\text{difference between bonus assumptions}} = \frac{\text{under-difference}}{\text{total of differences}}$$

Substituting,
$$\frac{x}{\$20{,}000} = \frac{\$11{,}720.40}{\$22{,}368.40}$$

Solving,
$$x = \$10{,}479.42$$

Correct Bonus
$$= \$21{,}000.00 \text{ minus } \$10{,}479.42$$
$$= \$10{,}520.58$$

Or (2),
$$\frac{x}{\text{difference between bonus assumptions}} = \frac{\text{over-difference}}{\text{total of differences}}$$

Substituting,
$$\frac{x}{\$20{,}000} = \frac{\$10{,}648.00}{\$22{,}368.40}$$

Solving,
$$x = \$\ 9{,}520.58$$

Correct Bonus
$$= \$\ 1{,}000.00 \text{ plus } \$9{,}520.58$$
$$= \$10{,}520.58$$

Proof:

Net Income, Before Bonus and Taxes		$100,000.00
Plus: Deductions Unallowable for Tax Purposes		1,200.00
Total		$101,200.00
Less: Actual Bonus (@ 20%), per foregoing calculation		10,520.58*
Tentative Basis for Taxes		$ 90,679.42
Less: Franchise Tax (@ 4½%)		3,900.57
Tentative Basis, as above	$ 90,679.42	
Less: Prior Year's Tax	4,000.00	
Basis for Franchise Tax	$ 86,679.42	
Basis for Federal Tax		$ 86,778.85
Less: Federal Tax (@ 38%)		32,975.96
		$ 53,802.89
Less: Unallowable Tax Deductions		1,200.00
Basis for Bonus		$ 52,602.89
Bonus (@ 20%)		$ 10,520.58*

*—Note that these figures are identical.

Hermaine Meinhardt holds a Bachelor of Arts degree from Hunter College (June, 1946), as well as a Master of Business Administration degree from The City College (June, 1950).

Her accounting experience has included service on the staff of a firm of CPA's., as auditor with the General Accounting Office at Washington, D. C., and as assistant to the vice-president of a large public utility holding corporation.

The 110th New York Certified Public Accountant Examination

NOVEMBER 8, 9 AND 10, 1950

THEORY OF ACCOUNTS

Thursday, November 9, 1950—9 a. m. to 12.30 p. m., only

This paper is intended to test the extent of your knowledge of accounting theory and your ability to apply the knowledge you have acquired. Due weight will be given to the arguments presented to support your answer to each question, even though the examiners may not agree with your conclusions.

Group I—Answer all questions in this group.

1 [15]

It has been stated that cost for inventory purposes may be determined under any one of several assumptions as to the flow of cost (such as "first-in, first-out," "average," and "last-in, first-out"); the major objective in selecting a method should be to choose the one which, under the circumstances, most clearly reflects periodic income.

a For what reasons do accountants make assumptions as to the flow of cost instead of actually identifying the cost of the specific items which are sold?

b In any given case, on what would you base your decision as to which of the three assumptions stated above, as to the flow of cost, most clearly reflects periodic income?

c Would application of the above directive always result in the clearest presentation of current financial position? Explain.

2 [15]

The Hassett Co., Inc. issued $1,000,000 of 20-year, 4% bonds dated May 1, 1949, interest payable May 1 and November 1. The company used the proceeds for plant expansion. The indenture requires the establishment of a sinking fund by annual payments of $50,000 to a trustee starting March 31, 1950. The indenture also requires an annual provision of $50,000 for a sinking fund reserve "to be set aside out of earnings."

The 1950 payment was made on March 31st and on April 1, 1950, the trustee purchased $50,000 face amount of the company's bonds on the open market. In view of this "reacquisition of bonds," the annual provision for the sinking fund reserve was omitted.

A financial analyst complains that the company's statement of net income for the fiscal year ended April 30, 1950, overstates earnings by $50,000, since it shows no charge for the annual payment to the trustee, and leads investors to believe there are earnings available for dividends which the company is in no position to pay.

Explain whether or not the omission of the reserve provision was justified and criticize the analyst's complaint. Include in your answer a discussion of the purposes of sinking funds and related reserves.

3 [15]

On July 1, 1945, the Plaza Company bought for $15,000 a patent on a production process from the inventor. At that date the patent had a remaining life of fifteen years. The company's policy is to amortize the cost of patents to production on a straight-line basis. The patented process proved successful with the result that profits were increased due to reduced production costs and a larger volume of sales obtained by lowered sales prices. Because of these factors, the production manager in 1950 estimated that, if the inventor had retained the patent, it would have been more profitable to pay him royalties

of $50,000 a year for an exclusive contract than to have continued with the former production methods.

On the basis of this estimate the board of directors voted as of June 30, 1950, to write up the patents account by $250,000. Out of the resulting credit they declared a common stock dividend of $200,000 consisting of 8,000 shares of their own $25 par value stock.

Describe how the action taken June 30, 1950, will change the balance sheet in future years. Explain fully whether or not generally accepted accounting principles were applied.

4 [16]

a The following information relates to the assets on the balance sheet of a manufacturing corporation:

(1) Under the caption "Machinery" is included the total purchase price of machinery being purchased on the installment basis. Legal title will not be acquired by the corporation until payment of the final installment which is due 18 months after the balance-sheet date.

(2) Under the caption "Deferred Charges" is included discount on bonds payable.

For *each* of the above items, state whether or not the corporation has followed generally accepted accounting principles and give reasons to support your conclusions.

b The last few items of an Income Statement appear as follows:

		$2,970,000
Provision for Federal income tax	$825,000	
Portion of loss on disposition of property (the balance of which is charged to surplus) equal to the estimated tax reduction attributable thereto	300,000	1,125,000
Net income for the year		$1,845,000

Explain fully the nature of the $300,000 expense and give reasons for presenting it in the financial statements in the manner illustrated.

Group II—Answer any three of the questions in this group.

5 [13]

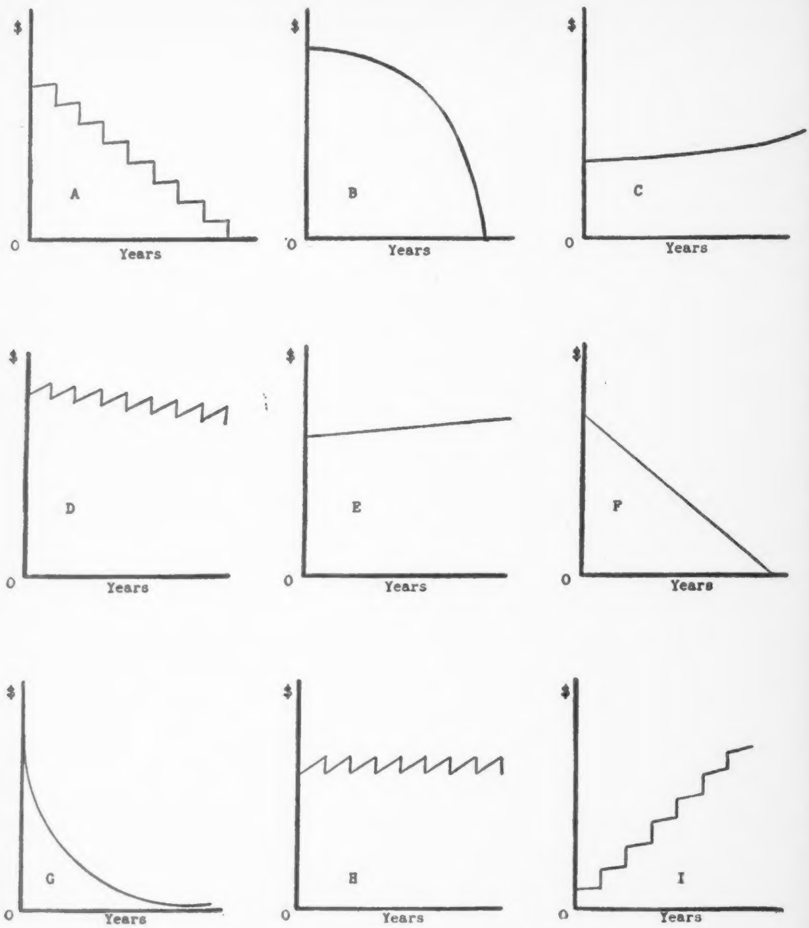
The Hunter Corporation manufactures a seasonal product, new models of which are brought out annually early in August. Sales of the old model are continued through August in outlying territories. Monthly sales to established outlets on net 20-day terms gradually increase until they are highest in the winter months and then taper off so that inventory quantities are lowest on June 30, before material and parts for the new model are purchased. Development of a new model is started in January and involves relatively large expenditures for design, engineering, dies and tools, culminating in a plant shutdown the last ten days of July to prepare for volume production on the new model starting in August.

The company wishes to change its fiscal year-end from December 31 to some other date. What date would you suggest they use? Discuss the advantages and disadvantages of the date you suggest, including consideration of the problem of income determination and the presentation of other significant financial information. Do not consider income-tax effects.

6 Describe the method of inventory valuation known as the "Retail Method" and explain why its application will ordinarily value an inventory at an amount less than cost. [13]

7 [13]

The following diagrams, lettered A through I, may be interpreted as rough graphic representations of the descriptions numbered 1 through 9. You are to match the diagrams with the descriptions in the following manner. (*a*) Place the letters A through I on your answer sheet, using a separate line for each letter. These letters identify the diagrams. (*b*) To the right of *each* letter insert the number which identifies the corresponding description.



(1) Asset valuation under straight-line concept of depreciation.
(2) Accumulation of an amount at simple interest.
(3) Valuation of bond and current coupon where purchase was at par.
(4) Accumulation of an amount at compound interest.
(5) Valuation of bond and current coupon where purchase was at a premium.
(6) Accumulation of a sinking fund.
(7) Asset valuation under physical deterioration concept of depreciation.
(8) The remaining fund after the annual distributions to the beneficiary of an insurance policy in the form of an annuity for a fixed number of years.
(9) Asset valuation under economic usefulness (economic value) concept of depreciation.

8 [13]

An agreement dated October 31, 1949, between the Bilada Company and its employees' union included a plan for employee pensions. The effective date of the contract and its pension provisions was January 1, 1950, provided, however, that the

m.

of
of

of

ts
ne
ne

ril

p
M
t

a
e
a

c
s

I
C
A

i
r
t

pension provisions would be effective only if ratified by the stockholders prior to March 31, 1950. Ratification took place on January 6, 1950. The contract, including the pension provisions was for a two-year term expiring December 31, 1951.

The pension provisions read that an employee of the Bilada Company is to receive a pension for life if he (*a*) shall reach the age of sixty-five, (*b*) shall have been employed by the company at least ten years at the date of his retirement, and (*c*) shall actually retire during the effective period of the contract.

The monthly amount of the pension shall be $5 for each year of service with the company less any old-age benefits to which the employee is entitled under the Federal social security program.

The company shall pay into a trust fund in five annual installments, the first in 1950, a sufficient amount to provide for the pensions of those who retire within the contract period.

Required:

The amount of the pension benefits depends on past services. Give the arguments in favor of *each* of the following methods of charging off the cost of benefits for services rendered prior to January 1, 1950, by those employees who are expected to be eligible to retire in 1950 and 1951:

a charged to earned surplus in full in 1950

b charged to income in the year the employee retires

c charged to income as the pensions are funded

9 [13]

a The following statements are to be considered as to whether they present correct statements of accounting principles and practices or whether they are essentially incorrect. On your answer sheet you are to list the letter and the numbers of each statement. Opposite *each* number indicate by the appropriate letter whether you consider the statement to be "True" or "False."

(1) Where appreciation of fixed assets has been recorded on the books of a business, it thereafter becomes necessary to charge against income an amount for depreciation based on the appraisal value. (*a*) True (*b*) False

(2) If a company uses a depreciation method which is based on the "sum-of-life-periods," the depreciation charge will be substantially smaller in the early periods of the life of the asset than in the last periods. (*a*) True (*b*) False

(3) The excess of the books value over cost of an investment in a subsidiary company at the time of acquistion is usually identified as "Goodwill." (*a*) True (*b*) False

(4) Capital surplus may properly be used by a business to absorb non-recurring charges if they are substantial in relation to the operation of the business or their inclusion in the income account would distort the profit for the period. (*a*) True (*b*) False

(5) The difference between the purchase price and the stated value of a corporation's common stock purchased and retired may be reflected in the current year's income account or, if the amount is large, directly as an earned surplus entry. (*a*) True (*b*) False

(6) A general purpose contingency reserve may properly be set up by charges to Expense annually, provided the amount is not so large as to result in a serious distortion of net income in any one year. (*a*) True (*b*) False

(7) Where a bond issued is retired before maturity with the proceeds from a new bond issue, any unamortized discount on the old issue should be combined with the discount on the new issue and amortized over the life of the new issue. (*a*) True (*b*) False

(8) Use of the last-in-first-out method of costing inventory is most appropriate in situations where sales prices do not change in response to changes in reproductive costs. (*a*) True (*b*) False

(9) Market, in the phrase "lower of cost or market" should not be less than net realizable value reduced by an allowance for an approximately normal profit margin. (*a*) True (*b*) False

b The following statements deal with cost accounting procedures. You are to indicate by the appropriate letter whether you consider *each* statement to be "True" or "False."

(1) Job cost sheets make possible the determination of work-in-process inventory values without the use of a physical inventory. (*a*) True (*b*) False
(2) Proper departmentalization of a plant is essential if direct costs are to be correctly charged to specific jobs. (*a*) True (*b*) False
(3) In process cost accounting, it is not essential to use individual material requisitions for each lot of material issued. (*a*) True (*b*) False
(4) A process cost system would not be suitable for a company manufacturing automobile engines. (*a*) True (*b*) False
(5) A mistake of estimating the stage of completion of work-in-process will affect the valuation of the work-in-process inventory but will not affect the valuation of the finished goods where a process cost system is in use. (*a*) True (*b*) False
(6) A plant may operate at more than 100% of productive capacity, as that term is used in standard cost. (*a*) True (*b*) False
(7) Historical cost systems do not provide as good a guide to plant efficiency as predetermined cost systems. (*a*) True (*b*) False

COMMERCIAL LAW

Friday, November 10, 1950—9 a. m. to 12.30 p. m., only

Reasons must be stated for each answer; no credit will be given for an answer unsupported by a statement of reasons. Whenever practicable, give the answer first and then state reasons. Answers will be graded according to the candidate's evident knowledge of the legal principles involved in the question rather than on his conclusions. Answers to questions involving negotiable instruments, partnerships and sales should be based on the provisions of the pertinent Uniform Law.

Group I—Answer all questions in this group.

1 [10]

a A merchant agreed to sell a suit of clothing to Carl, a young man who holds himself out to be 22 years old when in fact he is only 20. The agreed price of the suit was $100 although the fair market value was only $75. After receiving the suit, Carl refused to pay for it. May he thus disaffirm this contract? What remedy has the merchant?

b What are the time limitations upon the disaffirmance by a minor of contracts where the subject matter is (1) personalty, (2) real estate?

c What is the extent of the liability of a minor in a partnership in which he is a member?

d Name and describe *two* situations in which a minor can not give a power of attorney. Give the rule that applies.

2 [10]

a List *five* implied warranties of the seller of goods.

b (1) In a sale of goods what is meant by a seller's right of stoppage in transitu?
(2) Under what circumstances may a seller exercise such rights? Name *three* essential elements.

3 [10]

a Name and describe *five* points of distinction between a corporation and a partnership.

b Under what circumstances is a corporation bound by contracts of its promoters?

4 [10]

a (1) What is the general rule as to the liability of an undisclosed principal?
(2) Name *three* exceptions to that rule.

b X, who is actually the agent of Y in dealing with Z, does not disclose the fact of his agency but instead holds himself out as a principal and enters into an agreement with Z. Neither X nor Y perform under the agreement. May Z hold

(1) X alone? Why?
(2) Y alone? Why?
(3) Both X and Y? Why?

5 [10]

A borrowed $1,000 from B and gave B his negotiable promissory note due July 1, 1949. A pledged two bonds of X Corporation with B as security for the payment of the

note. Each bond had a face value of $700 and the pledge agreement authorized B to sell the bonds at private sale without notice to A, if A failed to pay the note at maturity. Give reasons for your answer to *each* of the following questions:

a On June 1, 1949, A notified B that he would be unable to pay the note on July 1 and requested B to sell the bonds immediately. B refused to sell although the bonds were worth their face value at that time, June 1. Was B justified in his refusal? Why or why not?

b On July 1, 1949, the note fell due and was not paid by A. The bonds were then worth a total of $1,000. B again refused to sell the bonds although requested to do so by A. A did not produce a buyer for the bonds. Was B justified in his refusal? Why or why not?

c On September 1, 1949, the note was still unpaid and B sold the bonds for $800 total, their value at that time. May B recover $200 more from A? Why or why not?

Group II—Answer any five questions in this group.

6 [10]

P purchased a car from S under a contract which reserved the title to S until the purchase price was fully paid, and reserved the right to S to repossess the car if P failed to make any of the required ten payments. A, an employee of S, was instructed by S to repossess the car from P. A was told by S that P had defaulted in making the second payment. A took possession of the car and delivered it to S. It is now found that P is not in default. Give reasons for your answer to *each* of the following questions:

a May P recover damages from A?

b May P recover damages from S?

c Suppose that P had been in default. The contract price of the car was $1,500 and P had paid S $520 before he defaulted. S resold the car for $800. Under the Uniform Conditional Sales Act may S recover the deficit from P if the contract is silent as to such recovery?

7 [10]

O was indebted to C in the sum of $50,000, the debt being unsecured.

a C obtained a $50,000 policy of fire insurance upon a business building owned by O. If the building is destroyed by fire at a loss of $65,000, is C entitled to enforce the contract against the insurance company? Why?

b If C took out a life insurance policy of $50,000 upon the life of O and O died eighteen months later, is the policy enforceable even though the debt has been reduced to $40,000? If so, to what extent? Why?

c On March 1, 1949, C obtained a judgment against O and had it on file in the county where O's unmortgaged building was located. On September 15, 1949, O became a voluntary bankrupt. Has C a superior claim to those of general creditors, even though he knew of O's insolvency when he obtained the judgment? Why?

8 [10]

A, in Cleveland, contracted to buy twenty cases of X Brand canned corn from B, in Toledo, at a contract price of $600. Pursuant to the contract, B selected and set aside twenty cases of X Brand canned corn and tagged them "For A". The contract required B to ship the corn to A via T Railroad, F.O.B. Toledo. Before B delivered the corn to the railroad, the twenty cases were stolen from B's warehouse.

a Who stands the loss of the twenty cases of corn, A or B? Why?

b Suppose B had delivered the corn to the railroad. After the corn had been loaded on a freight car, but before the train left the yard, the car was broken open and its contents, including the corn, stolen. As between A and B, who stands the loss? Why?

c Would your answer in part *b* be the same if this were a C.O.D. contract, all other facts remaining the same? Why?

9 [10]

a What is a bailee's lien?

b Under what circumstances may a bailee have a right of lien for charges for a bailment?

c May a bailee sell a bailed article and give good title to a bona fide purchaser?

10 [10]

a Black orally ordered a television set from Mastercraft Products Company for $1,000, but Black made no down payment. Mastercraft orally accepted the order, and later sent Black a written confirmation, entitled "Purchase Memorandum," containing all the terms of the order. A duplicate "Purchase Memorandum" was enclosed, with a request that Black sign it and return it to Mastercraft. Black kept both copies without signing either. When Mastercraft delivered the set to Black, Black refused delivery. Mastercraft sued Black for $1,000. Can Mastercraft obtain judgment? Explain.

b White orally ordered a television set from Mastercraft for $300, but White made no down payment. Mastercraft orally accepted the order, and later sent White a "Purchase Memorandum" containing all the terms of the oral order. A duplicate "Purchase Memorandum" was sent to White for his signature, but White neither signed it nor returned it. When Mastercraft delivered the set, White refused to accept delivery. Mastercraft sued White for $300. Can Mastercraft obtain judgment? Explain.

c Green orally ordered a $600 television set from Mastercraft but made no down payment. Mastercraft accepted the order and later sent Green "Purchase Memorandum No. 1208," in duplicate, containing all the terms of the order, and requested Green to sign the duplicate and return it to Mastercraft. Green kept both copies without signing either, but wrote Mastercraft as follows: "Referring to Purchase Memorandum #1208, please be advised that I am cancelling this order. Green." When Mastercraft delivered the television set, Green refused to accept delivery. Mastercraft sued Green for $600. Can Mastercraft obtain judgment? Explain.

d Brown orally ordered a $700 television set from Mastercraft and made a down payment of $100. When Mastercraft delivered the set, Brown refused to accept delivery. Mastercraft sued Brown for $600, the balance of the purchase price. Can Mastercraft obtain judgment? Explain.

11 [10]

O borrowed $60,000 from M and secured it by a mortgage on a business building owned by O. Give reason for your answers to *each* of the following questions:

a If the building is damaged by fire shortly thereafter, has M any prior lien on the insurance proceeds over the claims of other creditors of O?

b If O later leases the building to T for ten years and T pays a lump sum rental of $30,000 for the period in advance, how effective is T's lease in the event that M forecloses at the end of three years?

c If you were buying the building from O for $90,000 but paying only the $30,000 excess over and above the mortgage, would you prefer to buy it "subject to" or "assuming" the mortgage debt?

d Assume that O gave M a mortgage on the business building and lot X, each of which is worth $60,000, as security for the $60,000 loan. If he also gives a second mortgage on lot X to secure a $5,000 obligation to A, may A, if O defaults on the $60,000 obligation, insist that M foreclose only on the building if it will sell for enough to pay the debt in full?

12 [10]

A, B and C were partners. At the end of five years, C withdrew and D took his place with the consent of A and B. The business continued without liquidation. Three years later, the firm of A, B and D dissolved and liquidated. Answer the following questions using Uniform Partnership Act rules and give reasons for your answer:

a If the firm of A, B and C owed $4,000 to X, and the firm of A, B and D owed $6,000 to X and $6,000 to Y (who had not done business with the firm of A, B and C) how would the firm assets of A, B and D totaling $4,000 be distributed if a court were in charge of the liquidation?

b If C, at the time he withdrew had published a newspaper notice of his withdrawal, which notice was not seen by either X or Y, would C be personally liable for:

(1) the unpaid balance of the $4,000 debt to X?
(2) the unpaid balance of the $6,000 debt to X?
(3) the unpaid balance of the $6,000 debt to Y?

c What personal liability, if any, has D for *each* of the three debts mentioned, if he did not expressly assume any liability when he entered the firm?

The 110th New York Certified Public Accountant Examination

AUDITING

Friday, November 10, 1950—1.30 to 5 p. m., only

Answer all questions. Credit will be allowed not only for accuracy of answer but also for technic.

1 [15]

The Patricia Company had poor internal control over its cash transactions. Facts about its cash position at November 30, 1949, were as follows:

The cash books showed a balance of $18,901.62, which included cash on hand. A credit of $100 on the bank's records did not appear on the books of the company. The balance per the bank statement was $15,550, and outstanding checks were #62 for $116.25, #183 for $150, #284 for $253.25, #8621 for $190.71, #8623 for $206.80 and #8632 for $145.28. The cashier removed all of the cash on hand in excess of $3,794.41 and then prepared the following reconciliation:

Balance per books, Nov. 30, 1949		$18,901.62
Add—Outstanding checks:		
#8621	$190.71	
#8623	206.80	
#8632	145.28	442.79
		$19,344.41
Add—Cash on hand		3,794.41
Balance per bank, Nov. 30, 1949		$15,550.00
Deduct—Unrecorded credit		100.00
True cash, Nov. 30, 1949		$15,450.00

a How much did the cashier remove and how did he attempt to conceal his theft?

b Taking only the information given, name *two* specific features of internal control which were apparently missing.

c If the cashier's October 31 reconciliation is known to be in order and you start your audit on December 5, 1949, for the year ended November 30, 1949, what specific auditing procedures would uncover the fraud?

2 [12]

Generally accepted auditing practice calls for confirmation of receivables by direct correspondence with the debtors. The usefulness to the auditor, however, of receivable confirmations varies from client to client.

a What are the purposes for which the auditor uses the confirmation procedure?

b Briefly indicate why the usefulness of the replies might vary.

c What should the auditor consider in arriving at a decision as to whether to confirm all receivables or to confirm on a test basis? What should he consider in determining the extent of his test?

3 A retail jewelry store with seven salesmen and one repair man maintains a perpetual inventory record. In addition, the management wishes to take a complete physical inventory every month. Because you make the annual audit, you are retained to prepare instructions for their taking of the physical inventories. Briefly discuss the peculiar inventory problems involved in this business, and present in outline form the principal features to be included in the instructions you would prepare. [12]

4 [8]

An internal control questionnaire includes the following items. For *each* item, explain what is accomplished by the existence of the controls involved.

a Are each day's cash receipts deposited intact and without delay?

b If an imprest fund is represented by a bank account, has the bank been notified that no checks payable to the company should be accepted for deposit?

c Are write-offs of bad debts approved by an officer?

d Are pay roll disbursements made from an imprest bank account restricted to that purpose?

5 [6]

Nearly one third of the American Institute of Accountants rules of professional conduct are concerned with the certified public accountant's independence. On the other hand, the legal profession is not concerned with the independence of lawyers. Why is there a difference as regards independence between the legal and accounting professions?

6 [15]

a Outline an audit program to be followed in the audit of a large Endowment Fund held by a charitable institution. The assets consist principally of securities. This is your first audit of the fund.

b Prepare an illustration of the principal working paper or papers you would use in the verification of the securities and income from securities of the Endowment Fund. You need not use figures provided the heading of each column is specific or provided you indicate what would be entered in each column.

7 [22]

You are engaged in the regular annual audit of a company for the year ended December 31, 1949. During the year, employees of the company formed a union, and a contract was negotiated between the company and union. The contract was for one year from July 31, 1949. One section of the contract is reproduced following the questions.

a How might you discover the existence of this contract?

b Should existence of the contract be disclosed in your short-form report or on the financial statements? Explain.

c Would it be good accounting practice for your client to make an accrual for vacation pay at December 31, 1949? Explain.

d If an accrual for vacation pay were made, how could you verify the reasonableness of the amount?

SECTION OF CONTRACT DEALING WITH VACATION PAY

"Requirements to qualify for vacations with pay are as follows:

Para. V–1 An employee who has been continuously employed by the company for at least one year immediately preceding June 1, 1950, and who has worked at least forty-five weeks during such year, and who is an employee of the company on the day his or her vacation commences shall be entitled to a vacation. Said vacation shall consist of a period of six consecutive working days. A vacation of twelve consecutive working days shall be granted to an employee who has passed his eighth anniversary date of employment and who is otherwise entitled under the foregoing provisions of this section.

Para. V–2 For the purpose of determining eligibility under the preceding paragraph any period of time during which an individual has been off due to disability, injury or sickness not in excess of fifteen days, certified by a company physician, shall be construed both as time worked and as employment in the calculation of eligibility for vacation.

Para. V–3 An employee not yet fully eligible for a vacation to which he may subsequently become entitled during the then current year may anticipate fulfillment of the eligibility requirements and take his vacation without advance pay, provided the company consents.

Para. V–4 Vacations must be taken when due or be deemed forfeited. Vacation dates shall be subject to approval of the company and may be assigned to periods when the operation of a plant unit is shut down provided the company gives two weeks advance notice of such assignment of vacation period.

Para. V–5 No employee will be permitted to waive his vacation and receive vacation pay in addition to pay for days worked. Vacation pay will be duly given to an eligible employee on the pay day next preceding the start of his vacation and shall be subject to deductions for insurance, social security, taxes and all other regular deductions.

Para. V–6 Vacation pay shall consist of forty-eight hours pay for each six days of vacation at the employee's straight time rate in effect at the date of

commencement of his vacation. The night shift differential shall be excluded in the determination of vacation pay.

Para. V–7 If an employee who has qualified for a vacation in a prior year shall quit or be discharged, without having had his vacation, he shall be entitled to the proper pro rata of his vacation up to the date of his separation."

8 [10]

The Colmer & Dane partnership was formed to conduct an architectural practice. The accounting records, kept by the bookkeeper on an accrual basis, show the following income and expense items for the fiscal year ended June 30, 1950:

Income		
Billings for services		$32,360
Interest on U. S. Treasury bonds purchased in 1948, issued in 1940		200
Dividends on Indor Corp. stock purchased in 1948		30
Rent income for nine months on property owned at 250 Audobon Ave.		2,400
Total		$34,990
Deductions		
Salaries:		
Draftsmen	$10,000	
Bookkeeper	2,400	
Rent	210	
Depreciation:		
Furniture and equipment	180	
250 Audobon Ave.	900	
Taxes:		
Based on pay roll	450	
Property at 250 Audobon Ave.	400	
Federal income—Colmer	600	
Federal income—Dane	500	
Other	100	
Maintenance, etc. at 250 Audobon Ave.	700	
Contributions:		
Village community chest	100	
Political campaign chest	100	
Miscellaneous business expenses	1,880	
Loss on sale of:		
Property at 250 Audobon Ave.	150	
Indor Corporation stock	3,000	
Amortization of premiumu on U. S. Treasury bonds	15	21,685
Net profit		$13,305

Dane files his Federal income-tax return on a calendar-year basis. His share in the partnership profits is 40%. He withdrew $600 a month throughout 1949 and $500 a month throughout 1950.

You are to present the amounts, by classifications, to be reported by Dane in his Federal income-tax return for 1950 arising out of his interest in the partnership.

PRACTICAL ACCOUNTING — Part I

Wednesday, November 8, 1950—1.30 to 6 p. m., only

Solve any five problems. Consider technic and neatness as carefully as mathematics.

1 [10]

The following questions concern Federal income taxes. No reasons need be given to support your answer. Your grade will be based entirely on the number of correct answers you submit.

a Reed, aged 40, lived with his wife Helen, aged 38, his two children, John, aged 16, and James, aged 21, and his wife's mother, Jane, who died in her sixty-eighth year on January 15, 1949. Helen, John, James and Jane received more than half of their support from Reed and, with the exception of James who earned $550 during the summer vacation, they had no other income.

Reed, who reports on the cash basis, received the following income in 1949.

Third annual installment on an annuity which he purchased in 1939 at a cost of $20,000	$1,000

Gain from sale of his interest in a partnership which he entered into in 1944	5,000
Gain resulting from failure of Jones to exercise an option given by Reed on February 1, 1949, in connection with the sale of Reed's residence, the option expiring on October 15, 1949	500
Interest received on refund of Federal income taxes paid for 1948	500 500
Proceeds from 20-year endowment policy on life of Reed. Premiums paid thereon amounted to $4,000	$5,000
Reed paid the following amounts in 1949:	
Fee for preparation of Federal income-tax return..........	100
Fine for violation of a traffic regulation while driving his car on a business trip for his employer	10
Federal stamp tax on securities purchased	20
Penalty paid for late filing of 1947 Federal income-tax return	60

Reed stated that he donated 10 shares of X Corporation stock which cost him $500, to a charitable organization on July 1, 1949, at which date the stock had a fair market value of $600.

Based on the preceding information you are to answer the following questions concerning Reed's Federal income-tax return for 1949. Write down the numbers in a column and opposite *each* number write the answer. No reasons need be given to support your answer.

(1) What is the amount of income to be reported from the annuity?

(2) Is the gain from the sale of the partnership interest treated as (*a*) ordinary income, (*b*) a long-term capital gain, (*c*) some other way?

(3) Is the gain from the option: (*a*) ordinary income, (*b*) a short-term capital gain, (*c*) a long-term capital gain, (*d*) not taxable?

(4) Is the interest received on the refund of Federal income taxes to be included in 1949 income? (*a*)yes (*b*)no

(5) What portion of the proceeds from the endowment policy is taxable?

(6) To what amount is Reed entitled as a deduction for contributions in connection with the stock donated?

(7) Of the amounts paid in 1949, which of the following are deductible? (*a*)preparation of return (*b*)fine (*c*)Federal stamp taxes (*d*)penalty

b On Jannary 1, 1949, X Corporation and Y Corporation were merged, solely for corporate business reasons, into Z Corporation in what constituted a tax-free reorganization under Section 112(g) (1) (A) of the Internal Revenue Code. The assets of X which were transferred to Z included a building which was bought on January 1, 1921, at a cost of $100,000 (exclusive of land) and which had a fair market value on the date of the merger of $5,000. The assets of Y which were transferred to Z included a building which was bought on January 1, 1916, at a cost of $25,000 (exclusive of land) and which had a fair market value on the date of the merger of $100,000. No capital expenditures had ever been made on either building.

On July 1, 1949, Z Corporation purchased another building and its site for a lump sum of $50,000. This building was erected January 1, 1949. The appraised value of the building alone on July 1, 1949, was $39,000 and the appraised value of the land was $13,000.

The two buildings obtained from X Corporation and Y Corporation had an economically useful life for purposes of straight-line depreciation of fifty years from the date of construction. The building purchased by Z Corporation on July 1, 1949, had a useful life of fifty years from date of acquisition.

In preparing its Federal income-tax return for the year 1949 Z Corporation may deduct depreciation

(1) on the building received from X Corporation in the amount of (*a*)$2,000 (*b*)$100 (*c*)some other amount

(2) on the building received from Y Corporation in the amount of (*a*)$500 (*b*)$2,000 (*c*)some other amount

(3) on the building purchased on July 1, 1949, in the amount of (*a*)$1,000 (*b*)$500 (*c*)$375 (*d*)some other amount

c (1) On December 21, 1948, with the intent of erecting a new building, the

Gem Manufacturing Company purchased real estate for $28,000 upon which was located an old building. It allocated $22,000 for the land and $6,000 for the building. On January 8, 1949, it proceeded to raze the old building and then erected a new building which was completed at a construction cost of $40,000 on August 16, 1949. The cost of demolishing the old building was $3,000. The tax basis of the new building for depreciation and future sale purposes is (*a*)$40,000 (*b*)$43,000 (*c*)$49,000 (*d*)some other amount

(2) The Stanton Bolt Company was organized January 1, 1946, with its principal place of business in Chicago, Illinois. It realized net income and sustained net operating losses for each separate calendar year before applying net operating losses as follows:

Year	*Net Income*	*Net Operating Loss*
1946	$20,000	....
1947	......	$14,000
1948	......	13,000
1949	40,000	....

The net income for 1949 after applying the above net operating losses as carry-back and carry-over in the proper manner assuming that no adjustments are required under Section 122(d) either for computation of carry-back or carry-over, or of deduction is (*a*)$13,000 (*b*)$27,000 (*c*)$33,000 (*d*)some other amount?

(3) James Morgan purchased 100 shares of Amalgamated Company stock @ $80 per share on March 18, 1947. On December 20, 1948, he sold those 100 shares @ $60 per share. On January 5, 1949, he again purchased 100 shares of Amalgamated Company stock @ $65 per share. On July 26, 1949, he sold the latter 100 shares @ $92 per share. The tax basis he should use in computing the profit from the second transaction when he sold 100 shares @ $92 per share in 1949 is (*a*)$6,500 (*b*)$8,000 (*c*)$8,500 (*d*)some other amount

2 [10]

Arthur Jacobs, a merchant, kept very limited records. Purchases of merchandise were paid for by check but most other items of cost were paid out of cash receipts. Weekly the amount of cash on hand was deposited in a bank account. No record was kept of cash in bank nor was a record kept of sales. Accounts Receivable were recorded only by keeping a copy of the charge ticket and this copy was given to the customer when he paid his account.

Jacobs had started in business on January 1, 1950, with $20,000 cash and a building that had cost $15,000, of which one third was the value of the building site. The building depreciated 4% a year. An analysis of the bank statements showed total deposits, including the original cash investment, of $130,500. The balance in the bank per bank statement on December 31, 1950, was $5,300 but there were checks amounting to $2,150 dated in December but not paid by the bank until January. Cash on hand December 31 was $334.

An inventory of merchandise was taken on December 31, 1950, which showed $16,710 of merchandise on a cost basis. Tickets for Accounts Receivable totalled $1,270, but $123 of that amount is probably not collectible. Unpaid suppliers' invoices for merchandise amounted to $3,780. During the year Jacobs had borrowed $10,000 from his bank but repaid by check $5,000 principal and $100 interest. He has taken from the collections cash for personal expenses of $4,800. Expenses paid in cash were as follows:

Utilities	$554
Advertising	50
Sales help (part-time)	590
Supplies, stationery etc.	100
Insurance	234
Real estate taxes	350

Store fixtures with a list price of $7,000 were purchased early in January on a one-year installment basis. During the year, checks for the down payment and all maturing

installments totaled $5,600. At December 31 the final installment of $1,525 remained unpaid. The fixtures have an estimated useful life of 10 years.

Based on the above information, you are to prepare a statement of profit and loss for 1950, supported by all computations necessary to determine the Sales and Purchases for the year.

3 [10]

The Stone Manufacturing Company is closing its books as of December 31, 1949. In making an investigation of the accounts of the company, you discover the following facts:

a During November and December, the company shipped out stoves to two dealers, A and B, on a consignment basis. The consignment agreements provided that the stoves were to be sold by the consignee at a list price of $180 each. The consignee was to be allowed a 25% commission on each sale and was to be reimbursed for all expenses paid in connection with the shipment of the stoves to him. Sales on account are at the risk of the consignee.

b At the time of each shipment, the company debited trade accounts receivable and credited sales for $120 for each stove, this being the usual sale price received by the company on the basis of which a gross profit of 20% on cost is realized.

c All cash received from these two consignees was credited to accounts receivable. No other entries have been made in these accounts receivable.

d Information as to all of the transactions with the consignees is as follows:

(1) Stoves shipped out: to A—100, to B—40.

(2) Stoves unsold by consignees as of 12/31/49: A—35, B—25.

(3) Crating and shipping cost to company—$84.

(4) Freight paid by consignees: A—$130, B—$100.

(5) Cash advanced by A at date of receipt of the first 80 stoves—$4,000. Cash subsequently remitted by A—$5,395.

(6) Cash remitted by B—$575.

You are to prepare any adjusting entries that should be made by the Stone Company and you are to list *each* account affected by these transactions and adjustments, showing the corrected balance after adjustment.

4 [10]

From the following trial balances and additional information as of December 31, 1949, you are to prepare working papers showing Income and Expense for the year 1949 of each company and the consolidated income of P and its subsidiary.

Balances December31, 1949

	P Co. *Debit*	*P Co.* *Credit*	*S Co.* *Debit*	*S Co.* *Credit*
Cash	$ 23,000		$ 30,000	
Accounts Receivable	94,000		60,000	
Inventory 1/1/49—Cost	105,000		51,000	
Investment in Stock of S.	175,000			
Investment in bonds of S.	51,800			
Other Assets	445,000		210,000	
Current Liabilities		$ 163,000		$ 17,100
Bonds Payable—5%				200,000
Deferred Bond Premium				5,400
Sales		630,000		340,000
Purchases	485,000		300,000	
Operating Expenses	92,000		70,000	
Other Expenses	22,000		15,500	
Interest and Dividends		12,800		
Dividends Paid	20,000		10,000	
Surplus 1/1/49		107,000		84,000
Common Stock		600,000		100,000
	$1,512,800	$1,512,800	$746,500	$746,500

Additional information:

(1) The investment in stock of S Co. represents a 90% interest in the stock of S Co., which was acquired January 1, 1949, for $175,000. At the same time $50,000 face amount of bonds of S was acquired for $52,000. These bonds had been issued in 1939 at 106 and are due January 1, 1959. S Co. has recorded the amortization of the bond premium applicable to 1949 as an adjustment of interest expense. The stock and the bonds were not purchased from the S Co. but from the public.

(2) Included in the Purchase account of S Co. is a total of $180,000 of goods bought from P Co. at 120% of cost to P Co. The closing inventory of S Co. is estimated to include the same proportion of these purchases as of other purchases.

(3) Inventories at December 31, 1949, at cost to each company were:

P Co.	$80,000
S Co.	$45,000

5 [10]

A teller in a bank prepares a daily proof of his transactions. This proof is prepared by listing on the debit side the opening cash balance as a starting figure. The amounts of the various kinds of transactions handled during the day are then entered as debits or credits as indicated by the transactions. The cash balance at the close of the day is determined by actual count and entered in the proof. The proof should balance at that point unless there is an overage or shortage. Any overage or shortage would then be entered in the proof.

The following list includes all of the transactions handled by the head teller of the X Bank on November 10, 1950. From these transactions, you are to prepare a proof including the Closing Cash Balance as determined from the proof assuming there is no overage or shortage.

A.M. cash balance	$1,200
Deposits received	5,500
Checks received on other banks	3,600
Checks received on depositors	4,500
Loans granted	1,000
Interest collected	200
Expenses paid	100
Checks certified for depositors	300
Cashiers' checks redeemed	500
Loans collected from borrowers	5,000
Remittance to Federal Reserve for credit to our account	2,000
Certified checks redeemed	400

6 [10]

The Town of Blackwell uses budgetary accounts and separates its accounts into the following funds:

Identification letter	*Fund*
A	General Fund
B	Stores Working Fund
C	Special Assessment Funds
D	Agency and Trust Funds
E	Bond Funds
F	Property Fund
G	General Bonded Indebtedness Fund

During 1949 the following 14 transactions were among those taking place:

(1) The 1949 budget providing for $398,000 of appropriations and $400,000 of estimated revenue was approved.

(2) Construction of streets to cost $60,000 and to be financed by a levy on the adjacent property was approved.

(3) Purchase orders of $7,000 for the Fire Department were entered into.

(4) Current taxes of $350,000 were levied.

(5) Taxes written off in 1945 in the amount of $1,000 were collected.

(6) Serial bonds in the amount of $25,000 matured and were paid. This payment was contemplated by the appropriations for the year.

(7) A general bond issue of $50,000 was authorized, the proceeds to be expended for a building.

(8) The bonds in 7 above were sold for cash at par.

(9) Property costing $30,000 was retired with a cash salvage of $500 being received.

(10) The purchase orders of $7,000 referred to in 3 above were filled at a cost of $7,200.

(11) Stores were issued to the town clerk's office in the amount of $220.

(12) The building referred to in 7 above was completed at a cost of $49,500.

(13) Salaries of the Police Department amounting to $3,700 were paid after deducting $200 to go into the Police Pension Fund.

(14) Collections of taxes belonging to the county amounted to $17,400.

Write down the numbers 1 through 14, and opposite *each* number show, by use of

the appropriate letter or letters, the fund or funds affected by each of the 14 transactions. If more than one fund is affected, be sure to show all of them. If no fund is affected leave the space blank. Inclusion of an erroneous letter will result in a deduction of the same amount as will an omission of a letter. No reasons or comments need be given.

PRACTICAL ACCOUNTING — Part II

Thursday, November 9, 1950—1.30 to 6 p. m., only

Solve all problems.

1 [8]

Adams, Baker, Charles and Day are partners. Their interests in the capital and their profit and loss ratios are as follows:

Adams	40%
Baker	30%
Charles	20%
Day	10%

To provide a means whereby the remaining partners might purchase a deceased partner's interest from his estate, a life insurance program was inaugurated whereby life insurance proceeds would be paid to the remaining partners in proportion to their percentage ownership in the partnership. Since each partner was in effect insuring the life of each of the other partners it was agreed that no partner would pay any part of the premiums on policies covering his own life.

In 1949 the premium on all policies amounted to $9,000, which was charged as an expense on the books and thereby deducted from the year's profit. The profit was then credited to each partner in proportion to his ownership percentage.

Investigation of the insurance premiums revealed the following:

Premium on life of Adams	$3,500
Premium on life of Baker	1,400
Premium on life of Charles	2,300
Premium on life of Day	1,800

You are to prepare the correcting entry that should be made to the partner's capital accounts in order to reflect properly the agreement as to the insurance. Give your supporting computations in good form.

2 [12]

James Jones had the following transactions in the stock of the O'Mara Corporation:

a January 7, 1942, purchased 200 shares of $100 par value common stock at $110 per share.

b The corporation was expanding and as of March 1, 1943, issued to Mr. Jones 200 rights, each permitting him to purchase one-fourth share of common stock at par. The bid price of the stock on March 1, 1943, was 140. There was no quoted price for the rights.

c Mr. Jones was advised that he would "lose out on his other stock if he did not pay in the money for the rights." He therefore paid for the new shares on April 1, 1943, charging the payment to his investment account. Since he felt that he had been assessed by the company, he credited the dividends (10% in December of each year) to the investment account until the debit was fully offset.

d In December 1947 Mr. Jones received a 50% stock dividend from the company. He made no entry for this dividend because he expected to sell the shares received. He did sell them in January 1948 for $160 per share. He credited income with the proceeds.

e In December 1948 the stock was split on a two for one basis and the new shares were issued as no par shares. Mr. Jones found that each new share was worth $5 more than the $110 per share which he paid for his original stock, so he debited Investment with the additional shares received at $110 per share and credited income.

f In June 1949 Mr. Jones sold one half of his stock at $92 per share. He credited the proceeds to the investment account.

(1) You are to set up the Investment Account as it was kept by Mr. Jones.
(2) Prepare a schedule showing an analysis of the account as the transactions should have been recorded using the "average cost" method for recording stock sold.
(3) Prepare the entries that would be necessary to correct the income of each of the years in which Mr. Jones held the stock.

3 [30]

The following operating figures are obtained from the books of the March Manufacturing Company at December 31, 1949:

Sales		$903,900
Purchases	$418,052	
Processing labor	88,000	
Processing burden	132,000	
Baling labor and expense	4,104	
Selling and general expense	126,732	
Interest expense	4,902	
Discounts allowed	1,600	
Federal income taxes	69,000	
State income taxes	13,000	

The company was organized on January 1, 1949, to process certain waste material from textile mills. Most of the material processed by the company was purchased by it, but during 1949 it processed some materials under a contract with another company.

The material which it processes on a contract basis is consigned to the company. When complete, it is billed back to the accommodated company at a processing charge per pound. The same number of pounds received is billed back and the charge includes an amount charged for baling, as well as for processing. The material processed on a contract basis can be identified and losses in process are borne by the owner of the material. These losses in process are the same percentage of material processed as applies to material consumed in processing merchandise for sale. Such losses occur after the material has been processed but before baling and are due to discarding sub-standard production. Discarded material processed under contract is returned to the owner unbaled. The company makes a practice of selling its discarded product unbaled as it is set aside.

The two departments of the company are Processing and Baling. After coming from the processing department, the material is baled, using 400 pounds of processed material to the bale. Costs are separated by departments and the amounts given above include the cost of processing and baling the merchandise for sale and also the merchandise manufactured for other concerns. A fraction of a bale is considered to cost as much for baling as a full bale.

An analysis of the Sales account reveals the following facts:

Sales of finished product — 4,200 bales	$840,000
Sales of contract goods — 360,000 lbs. at 15¢ processing charge	54,000
Sales of scrap material —	9,900
	$903,900

The Purchases account shows debits for 2,080,000 pounds of material at $.20 per pound. The remaining amount shown in the account is for material used in baling the product.

In addition to the finished product sold, the company manufactured 75 bales of finished product which remained on hand. The inventory of material on hand December 31, 1949, amounted to 200,000 pounds. The goods in process weighed 80,000 pounds and were 50% complete in the Processing Department. There was no inventory in the Baling Department and there was no contract work in process at December 31.

You are to prepare a formal statement of Income and Expense for the year. This should be supported by a detailed Statement of Cost of Goods Sold and a Schedule of Manufacturing Costs by departments showing unit costs.

New York State Tax Forum

Conducted by Benjamin Harrow, C.P.A.

Deductions for Contributions—Franchise Tax

Entire net income is one basis for computing the franchise tax and, since this is presumably the same as that reported for federal income tax purposes, the deductions allowed under Article 9A are generally the same as those allowed by the federal government. The specific exceptions under Article 9A do not mention contributions and, since such expenditures are allowed under the federal law up to 5% of net income, the same rule would apply under Article 9A.

If the contribution can be classified as a business expense there would be no limitation on the deduction. To be a business expense the contribution must be an ordinary and necessary expense of the business. In the case of a contribution, that means that it must be actuated by a business motive and the relationship between the expense and the anticipated benefit to the corporation must be direct and definite. For example, if a corporation contributes to a local hospital in consideration of an obligation on the part of the hospital to provide hospitalization for employees of the corporation, the contribution is a business expense fully deductible, and not a contribution subject to the 5% limitation.

Under the federal law contributions are generally deductible on a cash basis. They may be deducted on an accrual basis only if they are paid by the 15th day of the third month following the close of the taxable year. While the franchise tax law has no similar provision, the same rule would probably be followed.

Benjamin Harrow, C.P.A., has been a member of our Society since 1928. He is a Professor of Law at St. John's University.

Mr. Harrow has been a member of the American Institute of Accountants since 1922 and is a member of the New York Bar. He is now serving on the Society's Committee on Federal Taxation, and is Chairman of its Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

Receipts for Tax Payments

Article 552 of the Income Tax regulations provides that the Tax Commission shall issue a receipt upon request for the payment of a tax. If the payment has been made by check the cancelled check is considered a receipt, but an additional receipt will be issued. Such a receipt will be issued promptly only if the check is certified or the payment of the tax has been made by cash or money order. Otherwise, the Commission will wait until the check has cleared the bank. A cash register receipt is issued for taxes paid in cash.

In the case of payments by uncertified checks, the date of receipt of the check is considered as the date of payment, unless the check is returned by the bank dishonored.

Priority of Tax Claims

In a recent case[1] the City Comptroller served notice by mail on purchaser and seller at a bulk sale of a possible claim

[1] *Klinghoffer* v. *Peter's Ridgewood, Inc.*, City Court, Sp. Term Part I, N. Y. Co., N. Y. Law Journal, p. 1157, November 13, 1950.

for city sales and business tax. Under the law, the city acquired a statutory lien against the funds transferred. Such a lien has priority over judgment creditors who thereafter served third party subpoenas.

The state, however, had a lien for unemployment insurance taxes. Such a lien attached when the taxes became due and this lien had priority over the city's lien. The court held that since the total claims of the city and the state exceeded the funds in the hands of the third party, the application of the judgment creditors for an order that they be paid out of the funds should be denied, even though neither the city nor the state had yet moved to perfect their statutory liens by seeking payment out of the fund.

The claim of the United States for taxes has no priority over earlier liens of the city and state, nor over judgment creditors who had served third party subpoenas prior to the service of notice of levy and warrant by the United States.

Classification of Corporation for Tax Purposes

A corporation had been taxed as a real estate company under Section 182. It owned and operated an apartment house and, under the law, was a real estate corporation wholly engaged in the purchase and sale of, and holding title to real estate. In 1943, it acquired two commercial hotels in Ohio and thereafter operated the hotels in addition to the apartment house.

The Tax Commission thereupon changed the classification of the corporation from a real estate company to a business corporation taxable under Article 9A. The taxpayer resisted the change on the ground that its activity within the state of New York had not changed and on that basis it was still taxable as a real estate corporation. The issue went to court[2] which held that there is no statutory authority for the assessment of franchise tax upon the basis of the type of business conducted in this state, only. A corporation is treated as a single entity. The acquisition of commercial hotels outside the state brought the corporation within the provisions of Article 9A.

As a business corporation it would be entitled to allocate its income, since it had a permanent and continuous place of business outside the state. If the commercial hotels were operated by a separate corporation to whom the properties could be transferred, the taxpayer could again be classified as a real estate corporation.

Proceedings to Review a Determination by the Tax Commission

Within 90 days after the mailing of a notice of a determination made by the State Tax Commission, the taxpayer may make an application to the Supreme Court for a review of the determination. Section 375 of the Income Tax Law provides that the review shall be made in the manner prescribed by the provisions of Section 199. This is a section of the law relating to the Franchise Tax.

Section 199 provides that the review may be had upon the law and the facts. In 1943, the law was amended and now provides that this procedure shall be the exclusive remedy available to the taxpayer. Amendments to Article 78 of the Civil Practice Act refer to the procedure as "Proceedings against a Body or Officers." Prior to the amendments to Article 78 this was known as a certiorari proceeding. The application by the taxpayer is made at a Special Term of the Supreme Court held *within the judicial district embracing the county within which the determination was made.* After the answer of the Tax Commission has been made to the taxpayer's petition, the Supreme Court on an order transfers the proceedings to the Appellate Division.

[2] *Central Park Plaza Corp.* v. *Bates*, Supreme Court, App. Div., 3rd Dept., January 10, 1951.

The argument is heard before that tribunal.

It has been the practice of the Tax Commission to require the taxpayer to initiate the proceedings for review before the Supreme Court, Third Department, which embraces Albany County, on the theory that the determination of the Tax Commission was made in Albany. An interesting case,[3] decided recently, raises the question of whether a review may not be brought in a jurisdiction where the "material facts" took place that gave rise to the determination that was made in Albany County.

In this case the taxpayer brought his proceeding in Kings County. That was where the taxpayer resided, and that was where he conducted his business and filed his tax return. The Tax Commission had made a motion to dismiss the petition for lack of jurisdiction or, in the alternative, for an order transferring the proceeding to Albany County. The pertinent section of the Civil Practice Act is Section 1278 which provides that the proceedings may be brought within the judicial district where the determination was made, *"or wherein it is alleged in the petition that the material facts otherwise took place."*

The court held that the words "material facts mean the underlying events which gave rise to the official action sought to be reviewed." If the material facts took place in Kings County the proceeding could be brought there even though the final determination was made in Albany County.

The court noted the fact that one of the seven district offices of the State Tax Commission is located in Brooklyn and that income tax returns may be filed at any one of the district offices. It should be noted that since December 16, 1946, the regulations (Article 530) under Article 9A require the filing of franchise tax returns in Albany. The court also noted that under Section 376 (6) the failure to do any act required under the provisions of Article 16 "shall be deemed an act committed *in part* at the office of the Tax Commission in Albany. Any prosecution under this section may be conducted in any county *where the person . . . to whose tax liability the proceeding relates resides, or has a place of business* or from which such person . . . received any income or *in any county in which such crime is committed or in the County of Albany."*

The court held that the taxpayer could institute the proceeding in Kings County.

Real Estate Losses—Ordinary or Capital

The foregoing decision in the case of *Brown, Jr.* v. *Bates* related to a procedural question. The substantive issue in the case is one that has troubled taxpayers for a long time. Are real estate losses deductible as ordinary losses or as capital losses? In this case the taxpayer was an attorney who claimed that he was also engaged in the real estate business as a speculator. As a result of his real estate transactions he sustained losses which he deducted from ordinary income. The Tax Commission determined that the losses were deductible only as capital losses for the reason that the taxpayer was not engaged in the real estate business.

Section 350 (12) defines a capital asset as property held by a taxpayer, but excludes property held primarily for sale to customers *in the ordinary course of a trade or business.* Therefore unless a taxpayer is in the real estate business the Tax Commission considers the sale of real estate as a speculator to be analogous to the purchase and sale of securities in the stock market as a speculator. The final decision in this case will be awaited with much interest. The Treasury Department has been more liberal in defining the doing of business in relation to

[3] *Brown, Jr.* v. *Bates*, Supreme Court, Special Term, Part I, Kings County, N.Y.L.J., p. 1741, December 29, 1950.

holding real estate than the Tax Commission.

Power of State Tax Commission to Compromise a Tax

Article 8, Section 171, of the Tax Law enumerates the powers and duties of the State Tax Commission. The nineteenth paragraph gives the Tax Commission authority to compromise any taxes or any warrant or judgment for taxes imposed by Chapter 60, Consolidated Laws. This is not a blanket authority. It is conditioned upon proof that the taxpayer is insolvent. The section contains another provision that the amount paid in compromise may not be less than what the Tax Commission could recover through legal proceedings of judgment, execution and attachment. If the amount owing for taxes exceeds $10,000, the compromise must be approved by a justice of the Supreme Court.

Chapter 60 includes the income tax law (Article 16) as well as the franchise tax law (Article 9 and 9A). Article 730 of the franchise tax regulations deals with the compromise of taxes in case of insolvency. This regulation refers to Section 171.19 of the law and repeats the provisions of the law indicating that they are applicable to taxes imposed under Article 9A. There does not seem to be any reference to the compromise of taxes under the income tax regulations, but since 171.19 refers to Chapter 60 and since the income tax law is part of Chapter 60 the Tax Commission presumably does have authority to compromise income taxes.

Treatment of Rent Payments Which May Be Applied Against Purchase Price

This situation came before the Tax Court recently.[4] While it involved a federal income tax question it is of interest to the writer because it also has a state income tax aspect. In addition, the issue raises a question of the proper accounting treatment of such payments.

In the instant case the taxpayer entered into an agreement to "buy" from the "seller" the latter's stoker business. Liabilities and receivables were excluded from the transaction. The purchaser was to pay a specified royalty on all stokers manufactured and sold. When the royalties reached a specified amount ($70,000) title to the business would vest in the purchaser. Over a four year period the purchaser paid $30,000 in royalties and deducted these payments as ordinary and necessary expenses. In the second and fourth years serious consideration was given to returning the business. However in the fifth year a final payment of $40,000 was made and the taxpayer then sold the business to another corporation.

The Commissioner disallowed a deduction for all the payments and determined a gain on the sale using $70,000 as the cost. The court recognizing the difficulty of the question resolved it in favor of the Commissioner. It said, "cases like this where payments at the time they are made have dual potentialities, i.e., they may turn out to be payments of purchase price, or rent for the use of property have always been difficult to catalogue for income tax purposes. . . . If payments are large enough to exceed the depreciation and value of the property and thus give the payor an equity in the property, it is less of a distortion to regard the payments as purchase price and allow depreciation on the property than to offset the entire payment against the income of one year. . . ."

Lessee's Improvements

Section 359 (a)(h) of the Tax Law provides that gross income shall not include the value of property attributable to buildings erected or other improvements made by a lessee acquired by a lessor upon the termination of a lease. This provision was added to the

[4] *Chicago Stoker Corporation* v. *Com'r.,* 14 T.C. 441 (1950).

law in 1943, and followed a similar change in the federal law in 1942 when Congress deliberately overruled the effect of the United States Supreme Court decision in *Helvering* v. *Bruun*.[5] This case held that upon termination of a lease the lessor realized taxable gain from improvements erected by a lessee.

The provisions of the federal and state income tax laws are not blanket exemptions from income to the lessor of all improvements made by a lessee. Article 81 of the regulations clearly provides that where improvements are made in lieu of rent, the exclusion does not apply. In such a case the lessor's interest in the improvements is immediately taxable in the year the improvements are made by the lessee. The tax is not postponed until the termination of the lease when the improvements become the sole property of the lessor. This is another situation where taxable income is realized but there is no actual cash available for paying the tax.

Return of Information at Source—Form 105

It is virtually impossible for the State Tax Commission to check the accuracy of all returns that are filed each year. It is even more difficult to round up tax delinquents, those who do not file any return. The Tax Commission has been devoting much time and effort to this problem and is now centering its attention on the information returns required to be filed at the source of income. Article 282 of the regulations requires an information return (form 105) for every single employee who has received income of $1,100 or more, and for every married employee who has received income of $2,750 or more. These returns are accompanied by a summary on card form 106.

The information returns are used to check the individual returns that are filed by the recipients of the income. If the employer is delinquent in filing the information returns, the work of the Tax Commission in tracing tax delinquents is hampered. The law provides penalties up to $500 for failure to file proper information. Complete information should be furnished, particularly the full names of employees and the social security numbers. Employers should comply fully with the requirements for filing these information returns. Otherwise, the Tax Commission will be compelled to assert penalties.

It should be noted that employers should have a Form 101 for each employee. This form is a certificate of residence. An employer is required to withhold the income tax from any employee for whom he does not have a certificate of residence.

Computation of Gain or Loss

A bill has been introduced in the Assembly, which repeals former Section 353, previously headed "ascertainment of gain or loss," and replaces it with a new section 353. In the main, the new section reclassifies the provisions with respect to the basis for determining gain or loss. A new section, 353(a), is added. This relates to all situations requiring an unadjusted basis for determining gain or loss. New section 353b relates to adjusted and substituted basis.

A new paragraph (9) is added to section 354. This provides that no loss shall be recognized upon the sale or exchange of property not used in the taxpayer's trade nor held for the production of income. This provision is intended to change the present law which permits a deduction for such a loss. It is aimed at the taxpayer who sells a residence at a loss. Until now such a loss has been deductible even though it is not deductible under federal law.

[5] 309 U. S. 461 (1940).

Other Bills Introduced at the Present Session of the Legislature

A bill has been introduced in the Assembly providing for an additional personal exemption of $600 to each person 65 years of age or older. If passed, this is to take effect January 1, 1952.

A bill has been introduced in the Assembly which would allow a deduction for federal income taxes paid. Each year some legislator introduces a similar bill, but the opposition of the State Tax Commission usually defeats it. The same fate is probably in store for this one.

A Senate bill would amend Section 377 (4) and provides that any refund of income tax shall be made without interest. The present section does not mention interest, but it has been the policy of the Tax Commission to add interest on overpayments. The new proposal does not appear to be fair to taxpayers, especially if additional taxes due are paid with interest added.

An Assembly bill seeks to change the provision with respect to the deduction for medical expenses. Under the present law a husband and wife who file a joint return may deduct medical expenses that exceed five per cent of the aggregate net income. The new proposal would change this to ten per cent. However the maximum deduction is increased to $2,000 instead of $1,500. A similar change is proposed for an individual who files a separate return. If approved the law is to apply to returns for any taxable year commencing on or after January 1, 1953.

AN ADIRONDACK VIEW

Syracuse. It's quite a town. Nice bunch of CPAs there. But, it's weather! It does not come down from heaven, it comes up from the other place. We attended a wedding in Hendricks Chapel at Syracuse University in March with the following developments:

1. *Discovery.* The father of the bride is a very important personage at the ceremony. This is bribery, pure and simple, he also pays the bills. Other CPAs have got caught on this one.
2. *Result.* We got a grown-up son and from the cost accounting standpoint the production costs by this method are much less than by the home grown method.
3. *Nomenclature.* Now it's the Spencers of Scarsdale, which is very classic in sound, with an Old English tone. Yes? And Went Gantt inhabits the same suburb. And Spencer, Senior, is an auditor, of all things.
4. *Official* delegate. The Syracuse Chapter sent its 4 best looking members.
5. *Modern youth.* The present crop is the best this country has ever raised. They sure do roll the ball. Get called for more fighting service, get married, take five days off, then back to college and work again as usual. We said to an Alpha Delta sister, "Guess the sun won't shine on the bride today." She came back with, "We don't pay any attention to the sun here in Syracuse. We make our own sun!" Every CPA can use that idea as a part of "recognized audit procedure" and "generally accepted principles of accounting practice."

LEONARD HOUGHTON
Of the Adirondack "Chapter"

Accounting at the S. E. C.

Conducted by Louis H. Rappaport, C.P.A.

Independence of Accountants

In the January, 1951, issue of this magazine, we printed fourteen informal decisions of the SEC dealing with the question of independence of public accountants. These decisions appeared in the appendix to an address delivered by Donald C. Cook, vice-chairman of the SEC, before the 1950 annual meeting of the American Institute of Accountants in Boston. While these informal decisions do not have the force of formal rules or regulations, they are of interest to accountants in that they show the SEC's thinking in respect of accountants' independence. Ten more of the informal decisions are printed below.

All of these decisions are worth reading, but the reader's attention is directed particularly to Numbers 19, 22, 23 and 24. In Number 19 the Commission merely stated that the relationship "casts doubt" upon the accountant's independence, a viewpoint which some accountants might be disposed to question. Numbers 22, 23 and 24 illustrate the position often taken by the SEC that an accountant will not be considered independent with respect to a registrant if the accountant or his staff participate in the posting or keeping of the accounting records.

15. A partner in an accounting firm loaned $600,000 to a former officer of a company which held a significant interest in the registrant. This loan was secured by substantial blocks of stock of the registrant and of an affiliate of the registrant together with options to purchase the shares pledged. The accounting firm of which this partner was a member withdrew from the audit of the registrant. Subsequently, question arose as to whether the accounting firm could certify to financial statements to be filed with this Commission by a subsidiary of the registrant.

Held, the accounting firm which was not independent with respect to a parent corporation could not be considered independent with respect to its subsidiary.

16. An accounting firm certified the financial statements of a registered investment company. The stocks and bonds of the registrant were kept in a safety deposit box in a bank and the members of the accounting firm had exclusive custody of the key to the safety deposit box.

Held, the accounting firm acting as custodian of the registrant's portfolio securities could not be considered independent for the purpose of certifying the financial statements of the registrant.

17. An accounting firm certified the financial statements of a bank. A partner in the accounting firm acted as a representative of the director's examining committee of the bank. In this capacity, he reviewed the loans made by the bank and made reports to the committee with respect to loans requiring special attention. A registrant, which was indebted to the bank for a substantial amount and whose loan had been reviewed by the accountant, intended to issue preferred stock amounting to about 75% of the loan. The preferred stock was to be junior to the bank loan and the proceeds from the sale of the stock were to be used for

Louis H. Rappaport, C.P.A., has been a member of the Society since 1933. He is a partner in the firm of Lybrand, Ross Bros. & Montgomery, C.P.A's., and is also a member of the American Institute of Accountants and of the American Accounting Association.

working capital purposes. The accounting firm of which this partner was a member had been asked to certify the financial statements to be included in the registration statement.

Held, the accounting firm of which this partner was a member could not be considered independent for the purpose of certifying the financial statements of the proposed registrant.

18. A partner in an accounting firm which audited registrant's accounts was appointed agent in control of certain buildings by the children of the controlling stockholder of the registrant. In such capacity, the accountant negotiated a lease with the registrant which occupied office space in one of the buildings. The partner in the accounting firm also acted as trustee of a trust of which the wife and children of the controlling stockholder of the registrant were the beneficiaries.

Held, the accounting firm of which this accountant was a partner could not be considered independent with respect to the registrant for the purpose of certifying its financial statements to be filed with the Commission.

19. A partner in an accounting firm which certified the financial statements of a registered broker-dealer maintained a cash account with the broker. The accountant effected transactions through the broker and left the securities in his possession.

Held, the maintenance of an open account with a broker, represented by cash or securities, or both, by a partner of a certifying accounting firm, casts doubt upon the independence of the accountant and the firm of which he is a partner with respect to the broker.

20. Two of the partners in an accounting firm certifying the financial statements of a registrant were also partners of a law firm engaged by the registrant to pass upon the legality of the securities which were being registered.

Held, the existing relationship was such as to jeopardize the status of the accounting firm in which these individuals were partners with respect to the registrant.

21. A partner in an accounting firm owned an undivided one-third interest in a block of a corporation's stock amounting to approximately 70% of the stock outstanding. The accountant was also an officer-director of the corporation. The accountant's firm did not audit the accounts of the corporation. The block of stock was sold to a registrant, a client of the accountant's firm. The accountant resigned as officer-director of the corporation and the corporation was merged with the registrant.

Held, the accountant could not be considered independent for the purpose of certifying the financial statements of the registrant to be filed with the Commission.

22. The bookkeeper-cashier of a registrant entered the armed forces and a junior accountant on the staff of the accounting firm which audited the accounts of the registrant was loaned to the registrant one day a month to perform certain bookkeeping tasks. The following represented the maximum work done in any one month by the junior accountant. He footed the books of original entry, posted to the general ledger, took off trial balances, reconciled bank statements, occasionally made entries in the blotters from company records of purchases and sales, made journal entries for regular monthly accruals, prepared journal entries correcting errors and omissions made by company employees, and prepared and entered closing journal entries at the end of the year at the direction of the registrant. He also prepared balance sheets and profit and loss statements from book figures.

Held, the accounting firm of which this junior accountant was a member could not be considered independent with respect to the registrant for the purpose of certifying its financial statements.

(Continued on page 299)

Notes on Recent New York State Unemployment Insurance Cases

Conducted by SAMUEL S. RESS

Are Professionals Employees or Independent Contractors?

A certified public accountant was recently held to be the employer of a woman accountant in his office under the following circumstance, although he maintained that the person in question was an independent contractor. An arrangement had been made between the CPA and the accountant in question whereby $50.00 a week would be paid to her to do certain accounting work. As part of the agreement, she turned over trust accounts of her own to the CPA. She was to prepare schedules, supervise the typing and cutting of stencils, and do proof reading. It was also agreed that when and if she needed additional help in her work, such help would be given by the other employees of the appellant and charged against her drawing account.

The certified public accountant never paid Social Security contributions for her, nor did he make Withholding Tax deductions from the payments made to her for federal income tax purposes. She worked in the office 5 or 6 days a week from 9:00 or 10:00 A.M. to 5:00 or 6:00 P.M., and used all the equipment of the office and did all her work under the name of the CPA. All facilities and stationery were furnished by the certified public accountant. No distinction was made in the office records between her accounts and those of the CPA. Her drawing account of $50.00 a week was always in excess of the earnings from her accounts and the difference was absorbed as an expense of the appellant. She had no separate business or office of her own, and her name was not listed in the telephone book as an accountant at the CPA's address. All accounting business at the certified public accountant's office was done in his name and was billed by him to the clients. The responsibility for the work was that of the certified public accountant.

The question to be decided in this case was whether or not the woman accountant was an employee of the certified public accountant or an individual contractor. The certified public accountant contended that the arrangement under which she was to receive a drawing account, based on piece-work rates for doing accounting work, did not make her an employee. He contended that both the agreement and the course

SAMUEL S. RESS has been an Associate Member of our Society since 1936. He is a member of the New York Bar and holds the Juris Doctor degree from the New York University School of Law, and the B.B.A. degree from The City College (New York) School of Business and Civic Administration. He is a tax consultant and has been a specialist in the payroll tax field since the inception of Social Security and Unemployment Insurance Laws in 1936. He has drafted legislation related to unemployment insurance, health insurance, wages and hours and workmen's compensation.

Dr. Ress, who has written a number of articles which have appeared in *The New York Certified Public Accountant*, is a member of the Society's Committees on Clothing Manufacturing Accounting and on Labor and Management.

of conduct showed that he was not to direct the manner in which she did her work.

The Appeal Board held[1] that the nature of the work was such that a minimum of direction and control was necessary. Since the appellant was personally responsible for the work, he retained the right to exercise control. The fact that the certified public accountant was compelled to seek outside his staff for a person to do his work, and that the compensation was fixed on other than straight salary arrangement, is not sufficient to destroy the employee relationship. (See Appeal Board Case #1383-39).

In the matter of *Renouf* v. *N. Y. Central Railroad Co.,* 229 Appellate Division 58 (reversed on other grounds, 254 NY 349), the Appellate Division stated . . . "it is common knowledge that it frequently happens that lawyers, doctors and other men of skill are employed at a regular salary for a definite period. Such a contract of employment creates a relationship of master and servant." In the case of *Parsons Sanatorium, Inc.,* 271 App. Div. 859, affirming Appeal Board Case #12630-46, the court held that physicians, directors of private hospitals, who rendered services to a hospital and received a fixed monthly sum for such work were employees, and contributions had to be paid to the New York State Unemployment Insurance Fund on the sums of money paid to them by the hospital. These physicians maintained outside offices for the independent practice of medicine and none had regular hours of attendance at the hospital, but each of them was subject to call. The sums paid to the doctors were not originally reported as remuneration to employees for Social Security and Unemployment Insurance Tax purposes. The hospital had not withheld any Income Tax from the sums paid to the doctors. Each reported the income received from the hospital as derived from his profession.

The Appellate Board concluded that the record in the accountant's case amply supports the Referee's decision, which found that the woman accountant was the employee of the certified public accountant and not an independent contractor. It was directed that the certified public accountant pay Unemployment Insurance contributions to New York State on her drawings.

Multi-state Employment Contributions Payable to New York

The New York State Unemployment Insurance Appeal Board[2] has held that a corporation engaged in the business of cleaning ballast on railroad rights of way, under contract with various railroads for this type of service throughout the eastern United States, is an employer of the men engaged in actually doing the work and liable for contributions on the wages paid to these men, under the N. Y. State Unemployment Insurance Law.

The work is accomplished by the use of ballast cleaning machines maintained on standard railroad flat cars owned by the employer, whose headquarters was in Ithaca, New York. The payrolls were prepared in Ithaca, N. Y., and control over the work assignments and transfers of the men was exercised from Ithaca.

All of the employees involved rendered services both within and without New York State. None of the services rendered by the employees in question were localized in New York State. The machine on which the employees did their work moved from state to state and, under the Unemployment Insurance Laws of some of the other states in which the work was done, the employer in question had been required to pay Unemployment Insurance contributions. By a special administrative ruling, the employer was required to make payments to the State of New Jersey. He contended that he would be subject to multiple taxation on the

(Continued on page 294)

[1] New York Appeal Board Case #24514-50, decided January 19, 1951.
[2] Case #20,929-49, decided December 15, 1950.

Office and Staff Management

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

Clients' Filing Systems

In many offices, particularly of medium and small businesses, the filing systems are treated like the proverbial step-child. Since an audit program does not generally call for a check of the filing system, and even a survey of internal control does not call for much attention to the files, this subject usually gets only casual consideration from accountants.

However, there are few services that an accountant can render that will develop more good will than the correction of a poor filing system. For the time lost and nerves frayed by the inability to find papers are beyond measure. Moreover, the unnecessary accumulations of paper, and space wasted, also defy calculation.

Those accountants who are equipped to make a survey of the files, and submit recommendations, should be able to earn additional fees thereby. Others may recommend the engagement of any one of a number of large filing equipment manufacturers who render such services. Some companies claim to be neutral in their recommendations, suggesting the most satisfactory equipment, and forms, regardless of the manufacturer, but they generally make a charge for their service. Other companies, who recommend their own products exclusively, frequently make no charge, depending on the time involved and the consequent sale made.

Staff Compensation

A question often pondered seriously is one concerning the 'prevailing' standards of compensation for staff and office employees. At a time such as the present, the question has a note of urgency. Actually, there is no yardstick to measure the worth of an individual, but employment agencies are a factor in the development of some semblance of wage standards for large groups.

One employment agency (Robert Half) recently distributed a pamphlet listing prevailing salaries for accountants, stenographers, comptometrists, etc. in the early part of March, 1951. This may be of interest to those concerned.

Films for Staff Training

The firm of Aronson & Oresman has adopted the policy of showing specialized movies in connection with its staff meeting programs. This firm has an extensive practice in the textile industry and recognized that audit work, cost analyses, and even financial statements would be improved if the accountants were familiar, by visualization, with the industrial processes. Accordingly, films depicting the various mill processes are shown to the staff, with explanations which not only clarify the subject operation but also touch on the accounting aspects. This procedure has been found very helpful.

One film, describing the work methods of the ideal secretary, has also been displayed to the firm's secretaries, with resultant benefits.

There are extensive libraries of films embracing almost every conceivable phase of industrial and office methods. Accountants who are interested in the specialized development of their staff training programs would do well to investigate the use of films.

Employment Applications

A number of employment applications were submitted to this department for review. The variation was amaz-

John Doe and Company

Certified Public Accountants

New York City

Date________ Application for position as__________ (with John Doe and Company___
(with Client of J. Doe & Co.__

Name______________________________ Age___ Married or Single____

Address________________________ Home phone________________

Name of Employer____________________ Business________________

Business Address____________________ Business phone________________

EDUCATION: Institution	From	To	Studies Pursued	Degrees

EXPERIENCE: Employer & Address	From	To	Nature of Bus.	Reason for Leaving

REFERENCES: Name	Address	Relation to Applicant	Do you wish References Interviewed?

Salary expected per week? $____________

Will you accept a temporary position?__________

How soon can you accept an engagement:__________

(Please supply data above requested and return to John Doe and Co.)
Use reverse side and additional sheet, if necessary, for further information regarding yourself.

ing; some were poor, some were fair, very few were good. Only one form had a question as to whether the applicant was a C.P.A.; none asked whether the applicant had taken the A.I.A. achievement test; a few had a question re military status; none inquired as to what accounting and tax periodicals the applicant subscribed to and of what professional associations he was a member.

One of the application forms is reproduced on page 293. We would like to receive other specimen application forms from small and large firms. Some day, a standard application form may be developed from the material available.

Follow-up

Contributions of forms and data of general interest to administrative accountants are desired. Names of contributors will be published unless anonymity is requested.

Questions regarding administration are also solicited, and the replies which have general interest will be published in this column.

Notes on Recent New York State Unemployment Insurance Cases

(Continued from page 291)

same employment if he were also required to pay contributions to New York State.

The railroads for whom the work was done had one of their men direct and supervise the operation of the equipment and where and when the work was to begin. The speed of the machine was controlled by the speed of the locomotive pulling the car, but each was under the control of the railroad.

The railroad also had the right to remove employees of the ballast cleaning corporation from the railroad premises if they were not satisfactory to the railroad. The ballast cleaning corporation performed its work in 13 states and Unemployment Insurance contributions had been paid to the various states, based upon earnings of such employees in those states.

The Industrial Commissioner assessed the ballast cleaning corporation for $1082.34 in additional contributions, even though contributions on the wages of those employees had been paid to other states. The Appeal Board sustained the Industrial Commissioner's assessment against the ballast cleaning corporation. It held that section 511 of the New York State Unemployment Insurance Law provides for the application of successive tests to the entire service rendered both within and without the state, but only if some of the services are performed in the state.

All of the employees involved rendered services both within and without New York State. While the services of the employees were not localized in New York State, the place from which their services were directed or controlled was in New York State because it was exercised by the employer's executives in Ithaca, New York.

The Appeal Board did not attach any great significance to the control, such as it was, that had been exercised by the various railroads regarding time and place of the performance of the work by the ballast cleaning machines because the original employer had not divested itself of the ultimate control over its own employees. The Appeal Board further held that despite the fact that the employer may have been subject to multiple taxation, it was bound by the decision of the Court of Appeals in the *Matter of Mallia,* 299 N. Y. 232, which stated " . . . The activities of the general supervisor emanating as they did from the Brooklyn office, the preparation of the payrolls, the control over Mallia's transfer from job to job constituted such an exercise of the power to direct and control. That conclusion is sound and accords with the purpose of the Act.

The Excess Profits Tax Exchange

Conducted by David Zack, C.P.A.

The recent addition of the Excess Profits Tax to the accountant's manifold responsibilities has been described as the straw that broke the camel's back. However, this chore is no light straw and its impact may perhaps more closely resemble the effect of a ton of bricks. To add to his troubles, the flow of regulations, decisions, rulings and general literature will soon deluge the practitioner and this department has been instituted to attempt some alleviation of these Excess Profits Tax difficulties. The Excess Profits Exchange will regularly publish notes on all aspects of excess profits taxes and will act as a clearing house for questions, answers and comments on excess profits tax problems. Special emphasis will be placed on the procedural and substantive problems which confront the practitioner daily.

Questions, problems, and comments in regard to Excess Profits Taxes are solicited by this department from all readers and members of the Society. All queries will be answered, and items of general interest will be published in this column. Credit will be given to all contributors unless they specifically request anonymity. All inquiries and contributions should be addressed to:

Editor, The Excess Profits Tax Exchange
The New York Certified Public Accountant
677 Fifth Avenue
New York 22, N. Y.

David Zack, C.P.A., is a member of our Society and of its Committee on Municipal and Local Taxation and the Committee on Education.

Mr. Zack is a member of the New York Bar, the Federal Bar, and the Tax Bar. He is a Lecturer on Taxation at The City College (N. Y.) School of Business and Civic Administration, where he is currently conducting an intensive course on the New Excess Profits Tax Act.

Mr. Zack has written on tax matters for various publications. He is engaged in tax practice with a prominent New York firm of certified public accountants.

Tempora Mutantur

Should a rare skeptic imagine that the Excess Profits Act is not sufficiently complex to contribute an ulcer or two to the profession's collection, he can take comfort from the fact that most excess profits calculations made today, no matter how painstaking, are in all probability tentative and transitory. This results from the fact that corrections in net income made by the Bureau of Internal Revenue for any of the base period years or later excess profits tax years will change practically every item in the excess profits tax computation and require a completely new calculation. Average base period net income would, of course, be affected as would all equity capital computations, namely, base period capital additions, net capital addition or reduction for the current excess profits tax year, and invested capital. Even the historical invested capital would not be immune inasmuch as accumulated earnings and profits would vary with the Bureau's adjustments. The silver lining, of course, consists of the fact that adjustments increasing base period net income will ultimately react to the taxpayer's benefit in the reduction of

excess profits taxes for some years to come. This is especially true of adjustments requiring the capitalization of expenses and the reduction in depreciation and amortization writeoffs in the base period years. We may again witness the incongruous situation wherein the taxpayer vehemently argues for disallowances with a reluctant revenue agent.

Interim Statements

It is virtually impossible to determine accurately the excess profits tax liability for a corporation at an interim date because the tax does not take effect below a specified level of earnings, an artificial ceiling is provided, and later earnings and losses would seriously affect the final excess profits tax liability for the period. There has been no satisfactory solution developed, but various alternatives are used by auditors in issuing interim statements and this department would especially welcome comments and suggestions from practitioners in regard to this item. The following alternative presentations are suggested for discussion; however, only good auditing judgment can determine the proper treatment for a particular situation.

(1) A reasonable estimate may be made of the net profit which the corporation will show for the full taxable year and the aliquot portion of the tax accrued for the interim period. The difficulty in this method is the prognostication of future earnings.

(2) The excess profits net income for the interim short period could be annualized and the resultant tax deannualized for the applicable period. This method could yield very distorted figures, especially in seasonal businesses, since it is predicated upon the assumption that profits would be earned ratably over the entire taxable period. Otherwise, annualization could only be predicated on the assumption that the corporation would be dissolved on the balance sheet date which would seem to be completely unwarranted inasmuch as balance sheets are of course prepared on a going-concern basis. This method also ignores the patent fact that under a system of progressive taxation, income earned in the latter portion of a fiscal period is actually subjected to a higher rate of taxation than income earned earlier in the period. Any effective rate applied equally to every portion of the period would appear to be inaccurate.

(3) If the excess profits net income for the interim period exceeds the excess profits credit for the full year, then the estimated liability for taxes may be computed on the assumption that the interim net income represents a full year's income. This would appear to be a conservative approach in the sense that the corporation would be liable for at least that amount of tax in the absence of future losses in the period which normally could not be anticipated.

(4) If the excess profits net income for the interim period is less than the excess profits credit for the full year, then the auditor might decide not to accrue any excess profits tax with the comment that the corporation has not yet reached a level of earnings equal to its excess profits credit and that no estimate of the excess profits tax, if any, can be made.

(5) The excess profits credit for the full year may be allocated on a monthly basis to the interim period and the excess profits tax computed on the full interim net income with the allocated credit. This method ignores the fact that income earned later in the period, after the annual credit has been exceeded, actually costs more, taxwise, than income earned earlier in the period. This method also fails to recognize the effect of the 62% limitation.

(6) The auditor may find it impossible to make a reasonable estimate of the tax and simply comment that none has been accrued because it was impossible to make a proper estimate. This method would seem to beg the question.

No matter which method is adopted by the auditor for a particular situation, it would seem desirable to comment upon the approach taken in the statement. Reader comment on this entire subject would be most helpful.

Due Dates, Extensions and Fiscal Years

Many practitioners have decided to seek extensions of time to file their excess profits tax returns in order to provide some time for meditation, prayer and preparation. In this connection it must be remembered that the EP form is simply a schedule of the regular form 1120 and not a separate form equivalent to the old form 1121 under the prior excess profits tax law. This is due to the fact that the current excess profits tax is integrated with the regular normal and surtax rather than a separately imposed tax as under the World War II Act. The Bureau of Internal Revenue has refused to grant a blanket extension of time to file returns, but will give "sympathetic consideration" to extension requests. It is therefore necessary to request an extension of time for the entire 1120, despite the fact that the 1120 may be completely prepared, with the exception of the EP schedule. The payment of unnecessary interest may be avoided by the payment of a substantial tentative tax with the request for time extension.

March 15, 1951, is now the due date for forms 1120 for corporations having a fiscal year ended after June 30, 1950, as well as calendar year 1950 taxpayers. However, the payments required from fiscal year taxpayers differ from the exactions from calendar year corporations. The former may still pay their tax obligations in equal quarterly instalments, but calendar year taxpayers must pay 30% in each of the first two quarters and 20% in the last two quarters.

Interest Adjustment With Minimum Credit

Many practitioners have inquired as to what interest adjustment is made, if any, in computing the excess profits net income for the current year when the $25,000 minimum credit provided under Sec. 431 is used in lieu of the average earnings credit provided under Sec. 435 and the invested capital credit provided under Sec. 436. The problem arises because the interest adjustments required by Sections 433(a)(1)(N) and (O) are specifically cross-referenced to the use of the average earnings credit and the invested capital credit provided in Sections 435 and 436. However, inasmuch as Sec. 434 specifically provides that the taxpayer must use the credit which results in the lesser tax under the entire subchapter, it would seem clear that the taxpayer should elect the credit which results in the smallest interest adjustment. This would always be the average earnings method described in Sec. 435 since the interest adjustment prescribed in Sec. 433(a)(1)(N) can never exceed the interest adjustment prescribed in Sec. 433(a)(1)(O) for the invested capital method described in Sec. 436.

THE ACCOUNTANT-GENERAL

(With apologies to Sir W. S. Gilbert's "Major General")

General: I am the very model of accounting versatility,
A paragon of virtue, with complete responsibility.
I've read the early history of balances statistical,
And sought bookkeeping errors with a zealousness sadistical.
I'm very well acquainted, too, with monetary doctoring,
So honest, nonetheless, I've taken tests with little proctoring.
About first-in and Lifo's flaws, I'm teeming with a lot of news,
With many cheerful facts about the tax department's latest views.

Chorus: With many cheerful facts about, etc., etc.

General: I'm very good at facing down a stuffy banker's glass-eyed gaze,
With clients I've a charming personality that always pays,
In short, in fiscal matters that require real ability,
I am the very model of accounting versatility.

Chorus: In short in fiscal matters, etc., etc.

General: I've burned the midnight oil to learn why Wall Street's stocks have ups and downs,
I answer questions easily concerning zlotys, yen and crowns.
I have a card to take a case before the U. S. Treasury,
(At least to the extent that lawyers urge is quite enough for me).
I can spot a phony story in a bankrupt's conversation,
I can puzzle out the meaning of a junior's cerebration,
Then I can add a column of six figures at a single glance,
And if the total's right, it will but prove a happy circumstance.

Chorus: And if the total's right, etc., etc.

General: Then I can use abacus, computator and comptometer,
As well as graph and slide rule, engineer's potentiometer.
In short, in fiscal matters that require real ability,
I am the very model of accounting versatility.

Chorus: In short in fiscal matters, etc., etc.

General: And when it comes to matters of a more aesthetic nature,
I am very well acquainted with artistic nomenclature.
I can hum a Bach toccata, fall asleep with Wagner's Lohengrin,
Play golf and tennis, gin and bridge, and very seldom fail to win.
I know the theme of Aristotle's thoughts and of Euripedes',
I understand Spinoza, Kant, and speak their language if you please.
In short I'm so well-rounded, that my claim to perspicacity,
Is verified by all who know, as nothing but veracity.

Chorus: Is verified by all who know, etc., etc.

General: But, here's the catch, the gimmick, for success in all my ventures,
Now I've gotten ulcers, graying hair, pot-belly and full dentures.
So take advice, accounting slaves, who all your energies expend,
Go dig a ditch, or tour the world, you'll wind up better in the end.

—JACK FRIEDMAN, C.P.A.

CORRESPONDENCE

To the Editor of *The New York Certified Public Accountant:*

The following letter from the Treasury Department points up a novel situation which may be of interest to your readers.

Very truly yours,

ABRAHAM J. BRILOFF

New York, N. Y.

* * *

U. S. Treasury Department
Washington 25

Office of
Commissioner of Internal Revenue
It: P:CA
BEB

November 30, 1950

Dear Mr. Briloff:

Reference is made to your letter of November 15, 1950, requesting advice as to whether a personal holding company derives a dual benefit from the 25 percent tax on net long-term capital gains under the Internal Revenue Code.

You illustrate your question by the following assumed set of facts:

"Assume a personal holding company (Company A) has income from interest and rent, say, in the net amount of $10,000. On this $10,000 the Corporation would pay income taxes (on Form 1120) of $2,500, and then on Form 1120 H, it would pay a personal holding company tax of, say, approximately $6,000 on Subchapter A net income of $7,500. It is apparent then that this corporation has paid a total tax of approximately $8,500 on its $10,000 of net income.

"Let us now assume that a second personal holding company (Company B) also has $10,000 of net income from interest and rent, but in addition thereto has long term capital gains amounting to $100,000. Using the alternative method, Company B would pay a tax on Form 1120 of $27,500, of which $25,000 would be the alternative tax on the long term capital gain. Turning to Company B's holding company return, it would start out with $110,000 in net income, from which it would presumably deduct $27,500 as income taxes (referred to above), leaving a Subchapter A net income of $82,500. Using the alternative method, which would require the deduction from the aforementioned amount in the sum of $100,000—the long term capital gains—it is apparent there will not be any income to be subjected to personal holding company taxes."

Section 505 (a)(1) of the Internal Revenue Code provides for the deduction of Federal income taxes, etc., paid or accrued during the taxable year in determining the Subchapter A net income on the personal holding company return, which included taxes paid or accrued with respect to net long-term capital gains.

With respect to the net long-term capital gains of any corporation, section 117(c)(1) of the Code provides in effect that the tax to be paid, in lieu of the tax imposed by sections 13, 14, 15, 204, 207(a)(1) or (3), and 500 shall not exceed 25 percent; therefore, the tax determined under Chapter 1 and attributable to the net long-term capital gains becomes a credit in the alternative tax computation on the personal holding company return, Form 1120H, consequently, the results shown by your illustrations do in fact prevail under the Internal Revenue Code.

Very truly yours,

(signed) E. I. MCLARNEY
Deputy Commissioner

Accounting at the S.E.C.

(Continued from page 289)

23. An accountant certified the financial statements of a registrant which were filed with the Commission. Prior to certification, the accountant posted to the general ledger entries covering a month's transactions and made all the closing entries.

Held, the accountant could not be considered independent for the purpose of certifying financial statements filed by the registrant.

24. Members of a firm of certifying accountants set up a registrant's books and maintained them for about six months until the registrant engaged a bookkeeper.

Held, the accounting firm could not be considered independent with respect to the registrant for the purpose of certifying its financial statements for the year in which the accountants kept the books.

OFFICIAL DECISIONS *and* RELEASES

SIXTEENTH ANNUAL REPORT
of the
SECURITIES AND EXCHANGE COMMISSION
(Fiscal Year Ended June 30, 1950)

Section Dealing With the Activities of the Commission in Accounting and Auditing

Many of the reports or documents required to be filed each year with the Commission contain financial data, mostly in the form of financial statements and related schedules. These are always a vital, often the most significant, element of the information the investor must have upon which to predicate investment decisions. Because the Congress recognized that accounting and accountants perform such an important role in achieving the statutory purpose of disclosure, and because financial statements lend themselves readily to misleading inferences or even deception, whether or not consciously intended, the statutes administered by the Commission deal extensively with accounting, and activities of the Commission in the field of accounting are necessarily significant.

Thus, for example, the Securities Act not only provides for inclusion in prospectus of balance sheets and profit and loss information "in such form as the Commission shall prescribe,"[1] but authorizes the Commission to prescribe "the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts. * * *"[2] Similar authority is contained in the Securities Exchange Act,[3] and more comprehensive power is embodied in the Investment Company Act[4] and the Holding Company Act.[5]

The Securities Act provides that the required financial statements shall be certified by "an independent public or certified accountant."[6] The other three statutes above mentioned provide that the Commission may require that such statements be accompanied by a certificate of independent public accountants.[7] The Commission's rules require that statements filed pursuant to the Securities Exchange Act and the Investment Company Act be so certified. The value of certification has for many years been conceded but the requirement as to independence, long recognized by some individual accountants, was for the first time authoritatively and explicitly stated by its introduction into the statutes. Out of this initial provision in the Securities Act and the resulting rules established by the Commission[8] there have grown concepts that have materially strengthened the protection afforded investors by eliminating certain unhealthy accountant-client relationships which theretofore were quite common.

Although the statutes administered by the Commission give it wide rule-making power, accounting, based as it is largely upon convention and existing financial and business concepts, is of such a nature that the Commission has not yet found it necessary or desirable in most areas to establish extensive accounting rules and regulations dealing with accounting problems. The Commission has prescribed uniform systems of accounts for certain public utility holding companies and for public utility mutual and subsidiary service companies. It has adopted rules under the Securities Act governing accounting and auditing of exchange members, brokers, and dealers. In the wider area dealing with industrial, commercial, and investment companies under the Securities Act, Securities Exchange Act, and Investment Company Act the form and content of most financial statements are governed by the Commission's regulation S-X.

The rules and regulations thus established do not prescribe the accounting to be followed except in certain basic respects. In the large area not covered by such rules the Commis-

[1] Sec. 10 (a) (1) (Schedule A, par. 25, 26).
[2] Sec. 19 (a).
[3] Sec. 13 (b).
[4] Secs. 30, 31.
[5] Secs. 14, 15.
[6] Sec. 10 (a) (1) (Schedule A, par. 25, 26).
[7] Securities Exchange Act, sec. 13 (a) (2); Investment Company Act, sec. 30 (e); Holding Company Act, sec. 14.
[8] See, for example, rule 2-01, regulation S-X.

sion's principal reliance for the protection of investors is on the determination and application of accounting standards which are recognized as sound and which have come to have general acceptance. This policy of the Commission is expressed in accounting series release No. 4 (1938) (one of the series of such releases inaugurated in 1937 to publish accounting statements and opinions which are of general interest).

One of the inevitable results of this policy has been constant contact and cooperation between the Commission and other governmental agencies and accountants both individually and through such groups as the American Institute of Accountants, the American Accounting Association, the Controllers Institute of America, the National Association of Railroad and Utilities Commissioners and others. The importance of this cooperation is emphasized by the great influence and responsibility inherent in the Commission's authority over the several thousand financial statements filed every year with it by most of the important commercial and industrial companies in the United States.

The accounting staff of the Commission is organized to handle the many day-to-day accounting problems that arise in the course of its work and to provide central responsibility for aiding the Commission in matters of accounting policy. The chief accountant has general supervision with respect to accounting and auditing policy and its application. He is assisted directly by a staff of trained accountants, and, in addition, by assistant chief accountants assigned to and responsible for the examination of financial data and other operating work in the Division of Corporation Finance, Division of Trading and Exchanges and Division of Public Utilities.

Examination of Financial Statements

The majority of the accounting problems with which the Commission is concerned arise from examination of financial statements or other data required to be filed with the Commission. In general, deficiencies revealed by examination are called to the attention of the registrant by letter. These letters of comment and the correspondence or conferences that follow have proved to be a most convenient aid in effecting corrections and improvements in financial reporting. Few matters involve prolonged discussion or dispute in spite of the tremendous volume of financial data reviewed each year by the Commission; and it is only in rare instances that formal procedures are necessary in order to procure disclosure.

Many problems arise as a result of inquiry by representatives of registrants, their accountants or counsel in advance of the actual filing of the material involved. Advance discussion of this kind is encouraged and experienced practitioners regularly follow this procedure in dealing with unique problems—thus saving valuable time for themselves and their clients. As a natural outgrowth of the fact that the Commission studies and is the repository of a vast reservoir of financial data, the staff is frequently called on to aid in the preparation of studies of current problems such as those involved in formulating the background of legislative proposals.

Proposed Amendment of Regulation S-X

Regulation S-X is the Commission's basic accounting regulation relating to the form and content of financial statements filed under the Securities Act, the Securities Exchange Act, and the Investment Company Act. This regulation was promulgated in February 1940 and in many respects simply brought together requirements theretofore contained in the separate registration and annual report forms. The only major changes in the regulation since its issuance in 1940 have been the addition in 1942 of article 6A relating to unit investment trusts, the complete revision in 1946 of article 6 relating to management investment companies and a new article 5A, adopted in 1948, applying to commerical, industrial, and mining companies in the promotional, exploratory, or development stage.

Many accounting and reporting problems have arisen during the 10 years that have elapsed since the adoption of regulation S-X. Both the incidence and solution of some of these matters have involved changed viewpoints, not only of industry and the accounting profession, but also of the Commission. Furthermore, entirely new situations have developed requiring the establishment of new procedures. For these reasons it has been thought desirable to revise the regulation.

When the present proposal to amend regulation S-X was made in September 1949, copies of the preliminary draft were sent to 325 persons and an additional 75 or more were sent to persons who requested copies, mostly as a result of an item in the October 1949 Journal of Accountancy which invited readers to obtain and comment upon the preliminary draft. Several accounting firms and professional groups requested additional copies so that, in all, approximately 600 copies were sent out. Approximately 175 persons, including 46 controllers or principal accounting officers of corporations, submitted comments.

The large number of comments and recommendations received was given a great deal of careful study. Amendments originally proposed were reconsidered as a result of these comments and the final revision of the proposed amendments was sent out and formal notice of amendment was given under the Administrative Procedures Act on July 12, 1950. In view of the great importance of the regulation, the most careful consideration

will be given to the additional comments and suggestions expected to be received before enactment of amendments.

Other Developments in Accounting and Auditing

The Commission's fifteenth annual report mentioned the disclosure and accounting problem that arose from the increasingly popular form of financing by means of long-term leases or more particularly the sell-and-lease-back device. To a considerable extent the Commission's disclosure requirements applicable to such transactions have been in existence for a number of years. Thus, item 5 of the schedule of "Supplementary Profit and Loss Information," rule 12-16 of regulation S-X, requires that there be stated certain minimum data as to annual rentals, if significant. In view of the very important nature of lease-type financing, particularly the fixed character of the commitment undertaken, the Commission has in the past several years asked that there also be given, by a brief reference in a footnote to the balance sheet, the principal details of significant transactions occurring within the year or years covered by the report. The Commission also has indicated that where the transaction is such that it is in substance a purchase of property, the transaction must, despite the lease form, be accounted for as a purchase. The principles were also adopted in the recommendation of the Committee on Accounting Procedure, American Institute of Accountants, in its Accounting Research Bulletin No. 38 issued in October 1949.

Although the Commission had earlier indicated its position with respect to accounting for the obligations created by corporate pension plans, during the current year it was found desirable to give further consideration to the matter. This did not involve the one-time troublesome question of the proper disposition of expenditures to fund payments or liabilities determined upon the basis of past services of employees. The propriety of charging such amounts direct to income rather than to surplus is no longer challenged. Accounting Research Bulletin No. 36 in November 1948 by the American Institute of Accountants is, in principal, in agreement with the Commission's view.

However, there arose again the problem of the accounting for possible or implicit liabilities associated with past service elements of pension plans where the corporation is under no contractual obligation to continue the plan beyond the current year or few years immediately following. In the case of actual liability arising from an irrevocable commitment to the future payment of pensions it was not difficult to conclude that any unfunded liability for past service benefits, actuarily determined, should, under accepted accounting principles, be set up in the accounts. At the date of adoption of the plan such liability would, of course, relate not only to employees actually retired or qualified for retirement but also to the past service of those employees who would not qualify for retirement until a future date.

Such completely irrevocable commitments apparently occur rarely, if at all. In recent months union-management negotiations, particularly in the steel industry, have led to the adoption of various plans which might not legally bind the employers to fund past-service elements even though in a typical instance the plan is, by contract, to continue for 5 years. Question arose as to the extent of disclosure required to be given in proxy statements coming before the Commission for examination.

As an accounting matter the Commission had earlier concluded that even though there is no contract, or the pension contract may run for a short period only, it would be unrealistic to ignore the probability that, once having installed a plan or entered into a short-term contract, the company will continue it. Accordingly it was believed that there should be disclosed in a brief footnote to the balance sheet not only the important terms of the plan, including estimates of amounts payable annually, but also the company's best estimate of the amount that would be necessary to fund, or complete the funding of, past service obligations at the balance sheet date on the assumption that the plan is to be continued. In the case of employees who have retired or are eligible to retire, an equally realistic approach seems to require that, apart from any question as to legal liability, balance sheet provision should be made in an amount equal to the sum necessary to fund the obligation.

Upon request, in connection with the proxy material filed with it, the Commission informally reconsidered its position and concluded that it could find no sound and reasonable basis for a different view than that held earlier as to the appropriate treatment in financial statements. The Commission also indicated that the disclosure requirements in proxy material, to be furnished to stockholders as a basis for stockholder action on the pension plan, are essentially the same as in the case of financial statements and that therefore substantially the same treatment should be given to the facts.

In September 1949, the British Government announced a very material devaluation of its currency in terms of the United States dollar. Devaluations were almost immediately announced by many other foreign governments with the result that a large number of domestic corporations engaged in business in these countries were presented with problems as to how to state the accounts of their foreign subsidiaries and branches in terms of United States currency. Since many of

these corporations publish quarterly financial data for the benefit of stockholders and others, prompt decisions were necessary. Although the Commission generally does not exercise jurisdiction over stockholders' reports as such, many inquiries as to the Commission's views were received from registrants in anticipation of the later filing of their annual reports.

The first problem presented in many instances was whether to continue the previous practice of consolidating foreign and domestic operations. The Commission recognized that the decision on this point is one primarily to be reached by the company and its independent accountants, having due regard for all the facts, and having in mind the objective of most clearly exhibiting the financial condition and results of operations of the parent company and its subsidiaries. While not then called upon to make a decision in any particular case, the staff, in answer to a number of inquiries, indicated its general conclusion that the consolidation question might well be determined upon the basis of the degree of integration of the foreign operations with domestic operations.

If such foreign operations are essentially an arm or extension of domestic operations, and are actively being conducted, the view held is that there is a presumption in favor of the consolidation thereof, despite the probable impact upon the foreign operations of unfavorable political and economic factors. If, in an instance of this kind, remittances to the parent company are restricted, appropriate disclosure of the facts would be necessary and the consolidated profit and loss statement should reflect only earnings of foreign subsidiaries which are available to the parent in terms of United States dollars. If, on the other hand, the foreign operations constitute a complete and separate business unit in and of themselves, and serious economic problems are presented, nonconsolidation would generally appear to be indicated. In the examination of reports filed with the Commission since these developments it has been observed that in a substantial number of cases foreign operations previously included in consolidation have been removed therefrom and, where falling within the Commission's tests of significance, have been reported on separately.

A more persistent question was whether, as a result of widespread devaluations and foreign conditions generally, any new principles were applicable with respect to the conversion of foreign assets into a dollar equivalent. It was the staff's opinion, expressed in numerous instances, that no new problem existed and that the well-established practices of the past are quite adequate and appropriate to cope with any situation that has come to its attention. The general principles applicable in the case of conversion of foreign net assets are well expressed in Accounting Research Bulletin No. 4 (1939) of the American Institute of Accountants. Question arose, however, concerning the extent to which losses recognized in connection with the devaluation should be recognized by charges against income. The staff's position, concurred in by the Commission in a recent informal ruling, is that losses of this nature, even though large in amount, are a risk incident to doing business and are therefore proper charges against income. This conclusion was arrived at independently of the general question of the propriety of charges and credits to earned surplus.

Among the proposed amendments to regulation S-X are provisions dealing in certain important respects with the above described problems as to long-term lease commitments, pension plans, accounting for operations of foreign subsidiaries, and the impropriety of direct charges to earned surplus.

Several of the annual reports of the past few years have commented upon a group of accounting cases that arises in the administration of rules X-17A-3 and X-17A-5 under the Securities Exchange Act, governing securities brokers and dealers. As has been noted, most of the difficulties encountered in this field of regulation are due to the large number of small firms and the fact that many of the required audits are performed by accountants unfamiliar with the Commission's requirements and apparently not well trained in the improved procedures of brokerage accounting and auditing practice. During the past year the Commission's staff, through correspondence and through direct contact by regional office representatives, continued to devote considerable time to improvement in this area. In most cases it was apparent that inexperience rather than deliberate evasion was the cause of the unsatisfactory reports filed. There were a number of cases involving certifying accountants, however, in which, although formal proceedings under rule II of the rules of practice were not necessary, the audit work failed completely to approach generally accepted auditing standards and required that informal action, usually warning or admonition, be taken.

The various changes by the Commission in its forms are described in the preceding sections discussing the administration of the various acts. There were no material changes affecting the work of acountants although of interest was the elimination of the well-known Form 1-MD and the extension of Form 10-K to annual reports pursuant to both sections 13 and 15 (d) of the Securities Exchange Act.

"The bonds William and I bought for our country's defense helped build a house for us!"

HOW U. S. SAVINGS BONDS PAID OFF FOR MRS. ROSE NYSSE OF BRISTOL, PA.

"There's nothing more wonderful than a house and garden of your own," says Mrs. Nysse, "and no surer way to own one than to save for it through U. S. Savings Bonds and the safe, sure Payroll Savings Plan!"

Mrs. Rose Nysse says, "In 1942 William and I started making U. S. Savings Bonds a part of our plan for financial security. I joined the Payroll Savings Plan at the Sweetheart Soap Co. where I work, and began buying a $100 bond a month, knowing my money was safe and working for me. U. S. Savings Bonds certainly make saving easier!"

"Savings Bonds alone made a $5,000 down payment on our house!" says Mrs. Nysse. "Altogether, we've saved $8,000 just in bonds bought through Payroll Savings, and we are keeping right on. When we retire, our bonds will make the difference between comfort and just getting by. Bonds offer a patriotic and practical way to security."

You can do what the Nysses are doing —the time to start is now!

Maybe you can't save quite as much as William and Rose Nysse, maybe you can save more. But the important thing is to *start now!* It only takes three simple steps.

1. Make the big decision—to put saving *first*—before you even draw your pay.

2. Decide to save a regular amount *systematically*, week after week, or month after month. Even small sums, saved on a systematic basis, become a large sum in an amazingly short time!

3. Start saving by signing up *today* in the Payroll Savings Plan where you work or the Bond-A-Month Plan where you bank.

You'll be providing security not only for yourself and your family, but for the blessed free way of life that's so very important to every American.

FOR YOUR SECURITY, AND YOUR COUNTRY'S TOO, *SAVE NOW*— THROUGH REGULAR PURCHASE OF U. S. SAVINGS BONDS!

A PUBLIC SERVICE PROJECT · THE ADVERTISING COUNCIL

Your government does not pay for this advertisement. It is donated by this publication in cooperation with the Advertising Council and the Magazine Publishers of America as a public service.

oing

uch as
u can
is to
steps.

first—

system-
month.
basis,
t time!

in the
or the

ly for
r the
ry im-

OUR
V—
E OF